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THESIS

TURKEY'S ECONOMY: PAST PERFORMANCE AND FUTURE PROSPECTS

by

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June 1996

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**TURKEY'S ECONOMY: PAST PERFORMANCE
AND FUTURE PROSPECTS**

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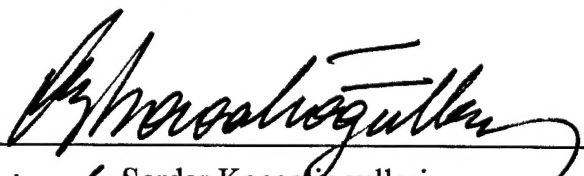
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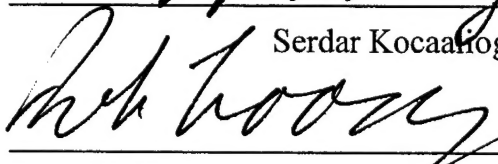
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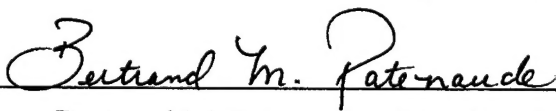
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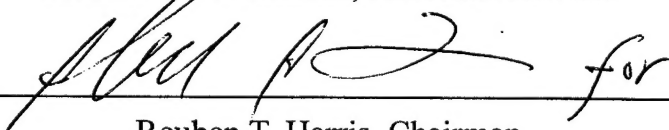
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ABSTRACT

The purpose of this study is to offer a fairly general discussion of the patterns of development in Turkey between 1923 and 1991 by contrasting the 1923-1980 period with the post-liberalization era of the 1980s, and to analyze the dynamics of economic growth and the concomitant mutation the economy underwent during these years. It also strives to demonstrate that despite some favorable effects, these liberalization attempts and structural adjustment policies failed to remedy some of the most important structural problems of the Turkish economy.

The body of the thesis has focused on the government's attempts and structural adjustment and liberalization, especially those occurring during the 1980s. Based on this analysis, the thesis brought an assessment of the sustainability of the Turkish program. Finally, generalizations have been drawn as to the efficiency of economic policy making in Turkey.

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I. INTRODUCTION

A. BACKGROUND

Until 1980, Turkish economic policies were typical of those of most developing countries. A policy of import substitution had been consistently followed since the 1950's, with prohibition of imports of commodities for which domestic production was deemed adequate. In part to foster import substitution, but more importantly because foreign exchange was always scarce, those policies were buttressed by quantitative restrictions on imports and tight exchange control, which increased the inner orientation of the economy even beyond that which would have resulted with those policies undertaken to encourage import substitution. State economic enterprises (SEEs) had been established and expanded to process and market agricultural commodities, to extract and export minerals, and to produce a wide variety of manufactured goods. Negative real interest rates enabled the government to direct resources through allocation of rationed credit, as well as through import licensing.

In the course of economic growth in the postwar period, the Turkish authorities had twice been confronted with mounting balance of payment difficulties and rising inflation. In both instances, there had been fairly typical stabilization programs, which succeeded in improving the foreign exchange situation and, in the earlier crises in 1958, drastically reducing inflation.

By the late 1970's, Turkey was confronting yet another crisis. Inflation had accelerated throughout the 1970's and reached an annual rate of over 100 percent by late 1979 -- this in a country with relatively few indexation mechanisms and strong sensitivity to inflation on the part of influential groups, including the civil service and the military.

While the political reaction to inflation alone would probably have forced policy changes, foreign exchange shortages at an increasingly overvalued exchange rate were also resulting in major difficulties and dislocations resulting in negative gross foreign exchange reserves by late 1979. There were long delays in obtaining import licenses and foreign exchange, embassy employees overseas went months without being paid, there was no coffee, and the short supplies of petroleum and other imports resulted in severe dislocations and hardships. According to the official statistics, real GNP fell only 5 percent over the 1977-79 period, but contemporary accounts and observations of those who lived through it suggest a far steeper drop, especially starting in the second half of 1979 [Ref. 7:p. 29].

Throughout the latter part of the 1970's, successive coalition governments had attempted unsuccessfully to grapple with economic difficulties. Several IMF-supported programs had been started, only to be abandoned when they proved infeasible to implement them. Governments changed frequently, largely in response to dissatisfaction with economic performance. By the beginning of the 1980's, it seemed clear that Turkey was in for yet another round of stabilization following the patterns of 1958 and 1970.

However, when policy changes came in early 1980, they were far different, both in announcement and in action, from the two earlier types. Instead of primarily addressing the macroeconomic issues driving inflation and the immediate balance-of-payments difficulties, the authorities announced a program that had two fundamental objectives: 1) to alter underlying economic policies aimed toward growth, and 2) reduce the rate of inflation. While this second objective had been included in both earlier programs, the enunciation and pursuit of the first objective constituted a major departure from past economic policies.

From its initiation, the sectoral reform program was articulated and designed to shift Turkey's entire growth strategy away from import substitution and toward

greater integration with the international market. Moreover, it was explicitly stated that the role of government in the economy was to be greatly diminished and that private enterprise would be relied upon to generate economic growth. In summary, the main objectives of the new Economic Stabilization Program were a reduction in government in production activities, increased emphasis on market forces, the replacement of an inward-looking strategy with an export oriented strategy of import substitution, and the attraction of foreign investment.

Policy reforms continued into the 1980s. Although macro reforms were initially successful, with the rate of inflation falling from over 100 percent to a low of about 35 percent in 1982, the rate of inflation rose again, and inflation continued to be a problem throughout the 1980's. By contrast, as the decade proceeded, the sectoral reforms geared to shifting reliance toward the private sector and integrating the Turkish economy with that of the rest of the world gathered momentum. By the early 1990's, it could be said that Turkey's reforms had been -- at least to 1991-- successful, while Turkey's macro reforms had failed.

We can identify six periods in Turkey's political and economic development process. The first period, from 1923 to 1950, witnessed the founding of the republic and rebuilding of the war-torn country through "Etatism" within a single party political system. During the second period, which roughly covered the 1950's, democracy emerged, with a multi-party system and the first wave of liberalization in economic management.

The third period was inaugurated in 1960 with the first of two coups d'etat and introduction of the concept of five-year indicative development plans, with heavy emphasis on import substitution. Since the first plan, which covered the 1963-67 period, there has been a continuous succession of five year plans and annual programs.

The fourth period, from 1971 to 1980, was a return to democracy, albeit an unstable one, in which successive coalition governments were too weak to respond to internal and external economic difficulties, political difficulties and changing circumstances. Of particular importance were episodes of civil violence between left and right factions and severe labor strikes.

The fifth period was marked by the successful implementation of a new economic reform program in 1980 under a military-backed government. Democracy was once again restored in 1983, under which the reform program continued uninterrupted and was even strengthened. However, during the rest of the 1980s the reforms met with gradually decreasing success even though the same technopol was in charge (in a higher office).

At the beginning of the current period, in 1990, a new, populist political coalition consisting of parties of the center-right and center-left (social democrats) came to power. The coalition government formed its own economic team, in which the management of the Central Bank represented the only continuity of the reform program.

B. OBJECTIVES OF THIS THESIS

The research and analysis involved in this thesis will contribute to an understanding of the Turkish experience in economic stabilization during the 1980s. The body of the thesis will focus on the government's attempts at structural adjustment and economic liberalization, especially those occurring during the 1980s. Based on this analysis, the thesis will assess the sustainability of the Turkish program. Finally, generalizations will be drawn as to the efficiency of economic policy making in Turkey.

C. RESEARCH QUESTIONS

The primary research questions are:

1. What were the implemented economic policies before 1980?
2. What were the institutional and policy oriented reforms and their priorities during the 1980s?
3. Which steps have been taken as part of the new economic policy?
4. How can we assess the level of success for infrastructural change?
5. Which recommendations can be made with regard to managing macroeconomic policies and long-run economic growth?

The subsidiary questions include the following:

1. What kind of external factors created the transition in the economy?
2. Which steps have been followed for structural adjustment in the 1980s?
3. What were the economic policy tools of the stabilization and liberalization periods.
4. How did implemented economic policy tools affect the performance indicators?
5. What were the favorable outcomes during the period?
6. What are the reasons for successful sectoral and failed macro reforms?
7. What are the main determinants of economic growth and macroeconomic policies, and how can we manage these factors?

D. SCOPE AND LIMITATION OF RESEARCH

The purpose of this study is to offer a general discussion of the patterns of development in Turkey between 1923 and 1991 by contrasting the 1923-1980 period with the post-liberalization era of the 1980s, and to analyze the dynamics of economic growth and the concomitant mutation the economy underwent during these years. It also strives to demonstrate that, despite some favorable effects, these liberalization attempts and structural adjustment policies failed to remedy some of the most important structural problems of the Turkish economy.

I do not expect, however, to capture the sociopolitical perspective of this complex transformation, nor to give a historical reasoning of this dichotomous period from an economic perspective. Much of the analysis in this study concentrates on the macro developmental aspects of the Turkish experience, without losing sight, insofar as possible, of the historical specificity of the underlying process.

E. ORGANIZATION OF STUDY

Chapter I will discuss the objectives and methodology of the thesis after a brief background. Chapter II will explain Turkey's economic situation before 1980 by dividing the period into subperiods and by analyzing the consequences of the implemented policies in these subperiods. Chapter III will investigate the 1980s' economic stabilization and liberalization policies and their effects on economic policy indicators in Turkey and statistical data will be investigated. Chapter V will present a reasonable approach, including all the pros and cons, to managing macroeconomic policies and long-run economic growth for the future prospects of the Turkish economy. Interpretation of all data and generalizations drawn to the efficiency of economic policy making will lead to the conclusion in Chapter VI.

II. TURKEY'S ECONOMIC SITUATION BEFORE 1980

A. GENERAL

Turkey became an independent state after the First World War as the Ottoman Empire disintegrated. With Atatürk as a national charismatic leader, economic policy for raising living standards was already an important issue in the 1920s and 1930s. After a brief effort to develop in the 1920s, Atatürk switched to Etatism [Ref. 1:p. 99] as a philosophy in the 1930s, and the first large State Economic Enterprises (SEEs) were founded, producing textiles, footwear and a variety of other manufactured goods.

Atatürk died in 1938, but remained the revered founding father of the nation. In the postwar period, economic growth resumed, with SEEs expanding rapidly into new import substitution activities. The underlying policy of Etatism remained the guiding principle of development efforts until 1980.

Turkey had pursued different development strategies and the performance of the economy in different periods and sub-periods since the foundation of the new Turkish Republic in 1923. But the key development strategy was for the state to intervene in the economic sphere, in order to lay the foundations for the development of private enterprise and to stimulate growth in those sectors of the economy neglected by private capital. The size of the domestic market and general international acceptance of this etatist strategy made it possible for successive Turkish governments to carry on building the economy behind closed doors, thus contributing to the emergence of a strong national middle class [Ref. 2:p. 80].

The years 1934-1948 were the period of implementation of the first industrial development plan in which an effort for achieving rapid industrialization was made under the etatist regime [Ref. 3:p. 295]. After development received attention, in accordance with the proceedings of the Izmir Congress, held in 1923, the strategy of

encouragement of the private sector was stressed. With the law of encouragement of industry put in force in 1927, private industrial investments were encouraged through various means available. But private savings and investments were not adequate at the time to achieve a satisfactory rate of economic growth and industrialization. In 1934, the government accepted the principles of etatism -- that is, giving the leading role to the state and State Economic Enterprises (SEEs) in attaining rapid growth and industrialization.

Etatism has been defined as intervention of the state as a pioneer and director of industrial activity, in the interest of national development and security, in a country in which private enterprise is either suspect or ineffective. A philosophy regarding the role and strategy of state enterprise -- development of basic industries and new industries of advanced technology, for example -- has to be translated into specific individual enterprise objectives and investment decisions. Integrity in objectives is important in itself; it is also necessary for unambiguous measures of performance. Several considerations must be taken into account in fixing the objectives of the state enterprises, such as financial return, economic return, capital intensity and labor intensity, and dynamic growth. [Ref. 7:pp. 19-20]

During the 1930s two new development banks were established to finance and control the expanding state industrial sector. The first of these, Sumerbank (Sumerian Bank), was set up in 1933 with a nominal capital of TL 20 million, increased in successive stages to TL 200 million by 1946. In 1935 a second state agency, Etibank (Hittite Bank) was established, with primary responsibility for the mining industry. Eventually, Etibank acquired total responsibility for the mining industry.

Beginning in the late 1940s, Turkey's economy grew rapidly, as the opportunities afforded by postwar recovery, receipt of Point IV and Marshall Plan aid, and a buoyant world economy all contributed to economic growth [Ref. 7:p. 7]. Simultaneously, there was a rapid increase in government expenditures, especially on

investment projects designed to accelerate economic growth. During 1950-1959, a crucial area of policy, as always, was the relative weight to be attached to the state and private sectors in industrial development. Early stages of development required the building up of infrastructure and expansion of basic industrial and agricultural materials by means of public investments and SEEs. Originally, the SEEs were supposed to operate with a high degree of autonomy and to strive for profits as a private business would have done.

Export growth ceased in 1953¹, due to the end of the Korean war commodity boom and the shift of resources to the buoyant domestic market. The rate of inflation accelerated simultaneously. As in many countries at that time, the Turkish authorities were committed to maintaining a fixed nominal exchange rate. By 1954, the government introduced import licensing in an effort to restrain the demand for imports in line with the availability of foreign exchange. Over the next several years, inflationary pressures intensified² while foreign exchange earnings continued to drop. By 1957 the situation was serious. Surcharges had been imposed on imports; even those who received import licenses waited eight to twelve months for foreign exchange permits. Export earnings were dropping rapidly, and the black market premium was more than 100 percent above the nominal exchange rate. At that time, as in many other countries, the top political leadership (Adnan Menderes) was opposed to any change in the nominal exchange rate. By then, Turkey was financing imports with suppliers' credits and other short-term, high-interest-bearing notes. As

¹Turkey had expanded the area under cultivation for wheat through introduction of tractors and mechanization in the late 1940s and was the world's largest wheat exporter in the early 1950s. The evidence suggests that this large effort was in fact uneconomic in the long run, and wheat exports peaked in 1952. For detailed information, see [Ref. 4].

²It is difficult to provide a good estimate of the rate of inflation. The Turkish authorities imposed price controls on most basic consumer goods in an effort to restrain inflation, and it was the official prices of those goods that entered into the official price statistics. According to those statistics, the rate of inflation reached an annual rate of almost 25 percent by 1958, having exceeded 10 percent annually since 1954.

the 1958 harvest approached, even that source of financing was disappearing, and it became evident that without a change in policy, little, if any, gasoline would be available to enable the trucks to move to ports.

Reluctantly, the government of Turkey agreed with the International Monetary Fund (IMF) to a stabilization program, the key elements of which were a major devaluation (from TL 2.8 to TL 9 per U.S. dollar); immediate import liberalization and rationalization of import licensing schemes³; ceilings on government expenditures, credit and the money supply; and an increase in prices of commodities produced by SEES, with the removal of price controls over most items for the private economy.⁴ Import liberalization was financed by the IMF and through other official credits; official creditors also sponsored and supported debt rescheduling for Turkey's outstanding debt. [Ref. 4:chap. 2]

Most of the components of this package are fairly standard in IMF-supported programs. A possible exception is the increases in prices of SEEs, which also featured prominently in the 1970s and 1980s reforms. As already mentioned, efforts to control inflation in the years prior to 1958 consisted largely of the imposition of price controls. Private sector firms responded either by shutting down or by selling on the black market. SEEs, however, sold at official prices and incurred losses. As inflation accelerated, these losses mounted. The losses, in turn, were covered by credits automatically extended by Central Bank to the various loss-making SEEs. The result was growth in the money supply fueled in significant measure by SEE deficits. Raising the prices of goods produced by SEEs in 1958 naturally resulted in an immediate increase in the various price indices; after that, however, the reduced rate of expansion of Central Bank credits resulted in a reduced rate of inflation. Indeed, the 1958 Turkish stabilization program was unusual in that real GDP, which had been

³For more detailed information, see [Ref. 4:chap. 6].

⁴For an analysis of the program, see [Ref. 5:pp. 197-219].

declining, started growing immediately in response to greater availability of imports, while the rate of inflation dropped dramatically: from 25 percent in 1958 to less than 5 percent in 1959. After the initial stabilization plan in the summer of 1958, export earnings rose, other foreign exchange receipts increased, and the flow of imports returned to more normal levels relative to the level of economic activity. Although there was a temporary setback in 1959 as the expenditure and other ceilings negotiated with the IMF were violated, a military coup in May 1960 was accompanied by a recommitment to the major provisions of the stabilization program. The rate of growth of real GDP accelerated, and Turkey was among the more rapidly growing developing countries for most of the 1960s.

However, Turkey's annual inflation rate in the 1960s was in the 5-10 percent range, and the nominal exchange rate was held constant after the 1958 devaluation. Public and private investment expenditures had increased rapidly in the early 1960s, financed largely by foreign aid. In the latter part of the 1960s, when foreign aid did not increase, the government attempted to maintain the rate of investment. The increased demand for imports resulted in lengthening the waiting list at the Central Bank. Delays in obtaining imports needed for spare parts and immediate goods increased anywhere from a year to eighteen months. The resulting excess capacity in newly established import substitution industries, combined with the slow-down in investment projects resulting from delays in obtaining imports, was a visible restraint on economic activity and growth. [Ref. 7:pp. 5-32]

Although inflation was accelerating, the foreign exchange situation was the biggest impetus to the 1970 devaluation. Even though circumstances were not as extreme as they had been in 1958, the import substitution activities that had been carried out during the 1960s had left the economy more dependant on imports of intermediate goods and raw materials to continue factory operations than had earlier been the case; inflation was not widely perceived to be a major problem. The 1970

devaluation had many of the same components as the earlier one, although emphasis was much more on the foreign trade regime and the exchange rate than in 1958. The nominal exchange rate was adjusted from TL 9 per U.S. dollar to TL 15; the government again received extensive foreign credits, and imports were liberalized.

In contrast to the 1958 devaluation, however, the economy's response to the 1970 devaluation was much more rapid. In particular, export earnings rose sharply, and at the same time, Turkish workers (Gastarbeiter) in Germany and other western European countries remitted sizeable amounts of foreign exchange. There was no mechanism readily at hand for the Central Bank to sterilize these inflows, and as a consequence, these remittances expanded the Turkish money supply sharply. Inflation therefore accelerated, although foreign exchange was plentiful. During the first half of the 1970s, real economic growth was rapid with expansionary monetary and fiscal policies. By 1975, real growth rates of around 7 percent annually was an unchangeable constant: Turkey had been growing rapidly and per capita incomes had been rising steadily since the early 1950s, despite population growth in excess of 2.5 percent annually. [Ref. 7:pp. 5-32]

Inflation had already reached an annual rate of 25 percent by 1973 when the first increase in the world price of oil was effected. Although the nominal exchange rate had been held constant since 1970, foreign exchange receipts from exports and from workers' remittances continued rising sharply, showing that there was no immediate foreign exchange problem. Indeed, the Turkish authorities were in the unaccustomed situation of accumulation foreign exchange reserves in 1971 and 1972. When the terms of trade deteriorated sharply because of oil, the authorities failed initially to alter the internal prices of petroleum and its products, instead, letting the SEE handling petroleum incur losses and financing the increased cost of imports out of foreign exchange reserves. Fiscal deficits therefore increased in 1974 and 1975, as the overvaluation of the exchange rate associated with accelerating inflation

increased, while the fiscal deficit itself and the failure to change the internal price of oil and its derivatives made the situation worse [Ref. 6:p. 346].

Table 2.1 gives data on the economic deterioration between 1975 and 1980. Imports increased sharply in 1980 after the January policy changes and the rapid downward spiral in real GDP was reversed. It is evident by these annual figures that real GDP grew only 15 percent between 1975 and 1980, while population increased by almost the same amount.

Acceleration of inflation resulted in economic discomfort for many influential groups -- the military, civil servants, academics, pensioners -- whose incomes were fixed without indexation. As seen in Table 2.1, imports continued to grow in 1976 and 1977, albeit slowly. However, by 1978, sources of financing were disappearing, and imports were reduced with consequent dislocations of economic activity.

Table 2.1. Indicators of Turkish Economic Deterioration, 1975-80

	1975	1976	1977	1978	1979	1980
Real GDP per capita (1975 = 100)	100	109	113	118	116	115
Wholesale prices (1975 = 100)	100	116	142	213	353	761
Current account deficit (millions of US\$)	1,648	2,029	3,140	1,265	1,413	3,408
Imports (millions of US\$)	4,502	4,872	5,506	4,369	4,815	7,513
Total debt (billions of US\$)	3.6	4.3	11.4	14.8	15.9	19.0

Source: Ref. 7, Appendix tables for first four rows, Table 6, p. 28 for debt.

One other phenomenon of the late 1970s was weak coalition governments during that period. In part, those weak coalitions reflected underlying divisions within society and societal unrest. This was reflected, inter alia, in the radicalization

of labor unions and of student groups, with attendant violence and civil unrest.⁵ It is estimated that eight million man-days were lost to strikes in 1980, compared to one million for all of 1979 [Ref. 9:p. 359]. The impact on the economy of the unions was substantial. On the one hand, they demanded, and most got, large wage increases. On the other hand, once wage increases were granted, unions were frequently reorganized under new leadership and went on strike once again to demand even more. From the viewpoint of Turkish industry, however, the strikes and work stoppages were highly disruptive and were at least as damaging as the delays and shortages of imports.

The Turkish economy was in severe disequilibrium by 1980. Inflation had reached triple digits and was still accelerating; imports were constrained, and the premiums on import licenses and on the black market foreign exchange were high and rising rapidly. Real output and incomes were falling. The reasons for this are clear in the policy indicators:

- A highly overvalued and unrealistic nominal exchange rate,
- a large and growing fiscal deficit and rapid expansion of the money supply,
- severe restrictions on foreign trade and domestic investment (because of foreign exchange difficulties).

In 1978 and 1979, two stabilization programs were negotiated with the IMF.⁶ Both of these programs were abandoned when the agreed-upon policies were not enacted, as the coalition governments were simply unable to restrain government expenditures, reduce SEE deficits, or raise taxes. When Suleyman Demirel became Prime Minister of another coalition government in the fall of 1979, he inherited an extremely difficult economic situation. He had no parliamentary support as had the

⁵For more detailed information, see [Ref. 8].

⁶For detailed information see [Ref. 10].

preceding governments under Bulent Ecevit, but the fact that the economic deterioration had been so prolonged perhaps gave him some room for maneuvering. In a sense, the usual political coalitions that had prevented action earlier were rendered ineffective by the severity of the crisis.

B. THE INITIATION OF ECONOMIC POLICY, 1923-1930

In 1933, at the height of the world economic depression, the new state of Turkey, a republic then barely ten years old, became the first of the "Third World" nations to undertake a planned economy. A doctrine for state planning had been laid two years before with the official adoption of etatism, which called for artificial stimulation of the economy through government intervention. During the first ten years of the Republic, the government in Ankara adhered to specifically Laissez-faire⁷ economic policies that had been spelled out early in 1923 by a national economic congress held at Izmir, during the interval between two sessions of the Lausanne Peace Conference.

In the course of the Izmir Congress of 1923 two crucial policy issues were debated at length. The first issue concerned the role of the state in the development of the economy. In his speech to the delegates, Mahmut Esat Bozkurt, the Minister of Economy, outlined the government's ideological stance:

We are not attached to Laissez-faire, socialist, communist, etatist or protectionist schools of thought. We have a new school of thought which belongs to new Turkey and corresponds to a new economic outlook. I call it the new Turkish Economic School [Ref. 11:p. 262]. The new Turkey should follow a mixed economic system, economic enterprises should be undertaken partly by the state and partly by private individuals. For example, the state should direct large scale credit and industrial undertakings [Ref. 12:p. 39].

⁷The theory of government that upholds the autonomous character of the economic order, believing that government should intervene as little as possible in the direction of economic affairs.

In general, however, it was to become clear that the government was initially ready to allow private enterprise the major role in industrial development, and to limit direct government intervention to basic public utilities and certain state monopolies which had a primarily fiscal purpose.

A second critical debate concerned the role of foreign capital in economic development. On this score, it is somewhat assumed that the new regime was hostile to foreign investment. This view is not supported by contemporary declarations and actions. It is certainly true that the republican government was determined to avoid indebting the state to foreign bondholders. On the other hand, they were fully prepared to allow foreign investors to undertake specific projects.

After 1923, direct government investment was mainly limited to the state monopolies. These had been established primarily to raise revenue, but they did not give the government an interest in developing the industries concerned. After a massive extension of the railway network, the government focused on the tobacco monopoly. Other government monopolies were established for matches and explosives and the import of sugar and oil products.

Although agriculture was obviously the basic source of Turkey's wealth, the government played a less active role in its development. Its principal medium of intervention was the agricultural bank which was reorganized in 1924.

In the broader field of fiscal and monetary policy, one of the new regime's first priorities was to balance its budget. As Table 2.2 indicates, the government had succeeded in balancing the budget in 1926, after previous massive deficits. This improvement was achieved by tightening up the collection of revenue, rather than cutting expenditures [Ref. 12:p. 44].

There was erratic growth during this period. One reason is that climatic conditions favored agriculture during the first three years of the Republic. Apart from this, recovery from wartime dislocation seems the most likely cause of the sharp

increase in economic activity from 1923 to 1926. Domestically produced goods began to replace imports. Before the First World War, Turkey had imported all her sugar; by 1927, the new beet-sugar factories were meeting just less than 8 percent of consumption, rising to 49 percent in 1932. By 1930, the share of textiles and sugar in total imports had been reduced to about 35 percent.

**Table 2.2. Government Revenue and Expenditure,
1913/14 to 1929/30 (TL million)**

Financial Year	Receipts	Expenditure	Receipts as % of Expenditure	Retail Price Index
1913/14	29.2	33.7	86.6	100
1917/18	31.7	60.3	52.2	-
1923/24	51.0	104.0	49.0	1,279
1924/25	111.3	135.2	82.3	1,343
1925/26	138.5	210.1	65.9	1,415
1926/27	170.4	179.9	94.7	1,466
1927/28	197.5	202.9	97.3	1,452
1928/29	204.6	204.2	100.2	1,474
1929/30	206.1	214.5	96.0	1,533

Source: Turkish State Planning Organization

In spite of the growth of import replacement industries during the 1920s, the overall situation of Turkey's foreign trade was less encouraging. The substantial foreign trade deficit of prewar days continued until 1923, but was thereafter reduced to 10-15 percent of Turkey's total foreign trade. The deficit increased again in 1929, however, as importers rushed to build up stocks before the imposition of the new, higher tariff. After this, imports were cut back sharply, so that Turkey actually had a positive trade balance in 1930.

C. THE ETATIST PERIOD (1930-1950)

1. Industry

The Etatist principles of economic development which were adopted by the regime during the 1930s have been subjected to any number of definitions and interpretations. The regime itself generally preferred to define Turkish Etatism as a home-grown product, arrived at by an objective analysis of Turkey's economic situation rather than dogmatic ideological commitments. In practice, the state had the major responsibility for undertaking new industrial investments, even if this left private entrepreneurs at a disadvantage.

The main practical attempt of the Etatist regime was Turkey's five year industrialization plan, which was drawn up in 1933 and put into operation between 1934 and 1938. The plan provided for the establishment of a series of industrial plants to reduce Turkey's need for imported consumer and intermediate goods using domestic raw materials. State agencies were to be responsible for financing, constructing and managing these plants. The main industries affected were the manufacturers of cotton and wool textiles, paper, ceramics, glass, cement, and some chemical products besides iron and steel. Emphasis was put on the industrialization of the backward regions of central and eastern Anatolia. Most of this development was realized within the plan period.

In order to finance and control the expanding state industrial sector, two new development banks were established during the 1930s. The first of these, Sumerbank, was set up in 1933, and the other, Etibank, in 1935. The initial capital of both banks was subscribed by the government or inherited in the form of assets from predecessor organizations. Subsequently, they derived their funds from further direct allocations from the budget, from government loans, and in the form of advances from the Central Bank on Treasury-guaranteed bills. From the beginning, they also operated as commercial banks, opening branches and accepting deposits from the public [Ref.

12:p. 57]. However, as time went on, these deposits represented a shrinking proportion of their total capital and liabilities. In other words, both organizations acted as state-owned holding companies with minor banking functions, rather than as state-controlled banks.

It was only during World War II that the government took stringent measures to control the private as well as the state sector of the economy. Whatever her prewar policies, Turkey, like other countries, was virtually compelled to introduce a new range of economic controls. In the process, the state sector increased its share of industrial output, at the expense of the private sector. Production by the SEEs increased by approximately 49 percent between 1939 and 1945, whereas that of the private sector rose by only 7 percent. The first economic casualty of the war was a second five-year industrialization plan, prepared in 1936, and intended to be put into operation during 1939-1943 [Ref. 13:pp. 3-9]. The only important new plant initiated during the second plan period was the iron and steel mill, which had been provided for in the first plan, but didn't begin production until the end of 1939.

After initiation of a multi-party system, the new Democratic Party's 1946 program stressed that private enterprise should play a much more active role in the economy and the limits of state economic activity should be clearly defined. During the postwar period, the Republican People's Party (RPP) government took some steps to put its new principles into practice. In particular, government monopolies in imported coffee, beer, wine and explosives were legally ended in 1946. The relative shares of the state and private sectors in the production of such items as cotton, where private enterprise had an important role, did not alter dramatically between 1945 and 1950.

2. Agriculture

The increase in demand for raw materials as a result of industrial expansion, together with the extension of the railway network, led to better prospects for those

farmers who could produce such crops as beets or cotton. From an average of approximately 500,000 tons per year between 1928 and 1935, the output of industrial crops rose to an average of approximately 1.2 million tons for 1936-1940 and 1.8 million tons for 1946-1950.

The state's most important intervention in agriculture during the 1930s was price support. Overall agricultural production, which had risen steadily during the 1930s, appears to have fallen during World War II. At the end of the war the regime attempted to tackle the general problem of rural poverty by enacting land reform legislation, but its efforts met with little success [Ref. 12:p. 63].

3. Labor, Social Policy and Education

Turkey's population growth rate fluctuated during the 1930s and 1940s. The average rate of increase stood at about 1.7 percent per year for 1935-1950, or an absolute rise of just less than 4.8 million (from approximately 16.2 million to 20.9 million). It was surprising that there had been no significant change in the structure of the workforce; indeed, industrial employment, as a proportion of the total, actually appeared to have dropped. Table 2.3 shows that a higher proportion of entrants to the workforce were engaged in agriculture and industry.

Table 2.3. Economically Active Population, by Sector (1935-1950)

	1935	1950
Employment, by sector	%	%
Agriculture	81.8	85.7
Services	9.9	6.9
Industry	8.3	7.4

Source: Turkish State Planning Organization

Before World War II, various SEEs, government departments and local authorities began to provide hospitals, clinics, and in some cases, retirement pension schemes for their employees.

Education was the most important area in which the Republican regime had focused its efforts. Expenditures on education, as a proportion of total budget, rose from 5 percent in 1930, to 6 percent in 1938 and 12 percent by 1950 [Ref. 14:p. 148]. The overall growth of the educational system between 1927 and 1950 is indicated in Table 2.4.

Table 2.4. Education Indicators, 1927-1950

Years	Population (millions)	School Enrollment (thousands)			
		Primary	Middle	High	University
1927	13.6	462.0	19.9	11.2	4.3
1940	17.8	813.6	85.0	27.6	10.2
1950	20.9	1,591.0	67.4	39.1	25.1

Source: Turkish State Planning Organization

4. Monetary and Fiscal Policy

The budgetary and monetary policies implemented during the 1930s were a continuation of the main principles followed during the second half of the previous decade.

Inflation was caused by excess demand. Since the interest paid on savings deposits has generally been well below the rate of inflation, bank customers hold savings as well as sight deposits for the sale of the liquidity rather than as an investment.

On the basis of the data in Table 2.5, it seems that the volume of currency in circulation increased by only about 21 percent between 1933 and 1938, in line with the conservative policies followed by the government. The rise in bank deposits was steeper, however, and the expansion of the banking system produced a significant increase in the total money supply. Most of the rise in money supply seems to have been absorbed by increased output of goods and services.

Table 2.5. Money Supply and Prices (TL Millions)

Years	Currency	Bank Deposits	Total 1 + 2	% Rise in 3	% Rise in GNP	% Rise in prices
1933	198	129	327	-	13.4	-
1934	205	128	333	1.8	6.7	-
1935	212	132	344	3.3	-2.4	11.8
1936	221	153	374	8.7	19.1	10.4
1937	235	183	418	11.8	3.3	4.7
1938	240	201	441	5.5	8.8	-4.6
1939	318	190	508	15.2	8.3	4.8
1940	430	191	621	22.2	-6.2	22.7
1941	564	224	788	26.9	-9.1	40.7
1942	700	289	989	25.5	4.5	92.1
1943	838	306	1,144	15.7	-9.3	74.0
1944	1,013	338	1,351	18.1	-4.2	-22.9
1945	1,051	416	1,467	8.6	-13.6	-3.0
1946	989	488	1,477	0.7	29.0	-3.2
1947	1,059	594	1,653	11.9	5.7	1.1
1948	1,106	663	1,679	1.6	13.4	7.5
1949	1,072	724	1,796	7.0	-4.5	8.0
1950	1,081	775	1,856	3.3	9.1	-10.2

Source: Turkish State Planning Organization

The establishment of a Central Bank in 1930 was a significant development. Some functions of the bank were to act as the government's fiscal agent, to rediscount commercial and agricultural bills, fix discount and interest rates, make advances to the Treasury, and to carry out controls on foreign currency. In 1938, the Central Bank was authorized to make advances on bills issued by the State Economic Enterprises (SEEs) and guaranteed by the Treasury, and to issue supplementary paper money accordingly. These new functions substantially increased the government's ability to resort to deficit financing, and had a crucial effect during subsequent years.

5. Foreign Trade

As the figures in Table 2.6 show, the consistent deficit in the balance of visible trade which Turkey had experienced during the 1920s was reversed in the following decade. Although the volume of exports increased substantially during the first half of the 1930s, the decline in commodity prices and the consequent worsening of the terms of the trade pushed down the value of exports between 1930 and 1933, with a moderate recover thereafter. Invisible imports and capital movements reduced these surpluses, so that the overall balance of payments has seen a deficit for some years.

Table 2.6. Balance of Visible Trade (Million \$ US)

Years	Imports	Exports	Deficit/ Surplus	Deficit/ Surplus as % of total trade	Nominal value of \$ in TL
1930	69.5	71.4	1.8	1.3	2.12
1931	59.9	60.2	0.3	0.3	2.11
1932	40.7	48.0	7.3	8.1	2.11
1933	45.1	58.0	13.0	12.5	1.66
1935	70.6	76.2	5.6	3.8	1.26
1938	118.9	115.0	-3.9	-1.7	1.26
1941	55.3	91.1	35.7	17.0	1.31
1944	126.2	177.9	51.7	17.0	1.31
1947	244.6	223.3	-21.3	-4.6	2.80
1950	295.7	263.4	-22.2	-4.0	2.80

Source: Turkish State Planning Organization

D. THE DEMOCRATIC DECADE (1950-1960)

When the Democratic Party stepped into power in Ankara in 1950, there were high hopes that Turkey had entered a brave and bright new era. The Democrats believed in incentives rather than directives as the driving force of national progress. In practical terms, they were determined to devote more attention to the problems of the neglected, but electorally important, agricultural sector and to encourage private industry at the expense of state enterprises.

For the first four years of the decade economic growth was high and generally satisfactory. After a period of postwar expansion, the Turkish economy showed sluggish growth and trade imbalances between the mid-1950s and the beginning of the 1960s. Annual growth rates of industrial production averaged 4.3 percent in the second part of the 1950s, while that of agriculture remained at 1.8 percent. Exports and imports fell below their 1953 levels and did not recover until 1960. It is during this period that comprehensive protectionist measures were introduced to overcome the persistent deficits in the balance of payments, together with price control programs, to curtail inflation. Although the origin of strong state intervention in the economy dates back to the early 1930s, a strong orientation toward import-substituting development strategies and interventionist development programs generated a revival of interest in the stagnant economic conditions of this period, despite the official policy of the government that preached laissez-faire and free competition. [Ref. 15:p. 1]

1. Industry

A crucial area of policy, as always, was the relative weight to be attached to the state and private sectors in industrial development. In his government program of 1951, Menderes declared that state undertakings other than those engaged "solely in fields related to basic industries and having a public character" should be turned over to private firms. And some of the State Economic Enterprises (SEEs) were actually transferred to private hands. Private industry was dominated by individual entrepreneurs who were generally unaccustomed to managing the large plants. Although some of the SEEs could make respectable profits, there was absolutely no incentive for private capital to take over such loss-making operations like the state-owned coal mines or steel industry.

The share of private and state sectors in capital formation fluctuated during the decade. During the first four years of the decade, agricultural production boomed,

increasing the overall level of economic activity, foreign exchange was freely available for the import of industrial inputs, and the rate of inflation was kept at a relatively low level. In these conditions, the private sector increased its investment and played its part in generating a sharp rise in industrial output.

After 1954, however, there was a serious deterioration. Agricultural production flagged, inflation rose to high levels, and there was a chronic shortage of foreign exchange on which industry depended for some materials as well as some equipment.

2. Agriculture

There were two principal planks in the agricultural sector: first, an increase in the supply of credit and the maintenance of minimum prices by state purchasing agencies, so as to boost the resources available to the farmer, and second, a massive increase in the import of tractors, so as to extend the cultivated area and to raise production. Overall public investment in agriculture rose as a proportion of total public sector investments from 15.4 percent in 1950 to 27.9 percent by 1959. [Ref. 4:p. 198]

Peasants used their extra resources to purchase tractors. Turkey still had a good deal of cultivable but unused land after World War II, and there was a severe shortage of draft power in relation to land and farm labor.

3. Labor and Social Policy

There was high population growth in the 1950s, as well as rural-urban migration. With the 1950 census, statistics also began to be gathered on the breakdown of the workforce by employment status. These reforms can be seen in Table 2.7.

In the educational sphere, there was a steady rise in registration at all levels of education.

Table 2.7. Economically Active Population, by Sector, 1950-1960

	1950	1960
Employment by sector	%	%
Agriculture	85.7	74.9
Services	6.9	10.2
Industry	7.4	9.6
Unknown	-	5.0
Wage earners	10.7	18.8
Employers	10.7	18.8
Unpaid family workers	62.9	47.9
Unknown	-	3.8

Source: Turkish State Planning Organization

4. Monetary and Fiscal Policy

The exact relationship between increases in the stock of money and rises in the price level in Turkey has been the subject of a great deal of highly technical discussion. The data from the 1950s suggest a rough, but not exact, link between increases in the money supply, the output of goods and services and the price level. From 1950 to 1955, the stock of money increased by approximately 20 percent per annum. For the first three years, there was a steady increase in output to soak up the extra supply of money, and inflation was held at a low level of 3-7 percent per annum. But, in the second half of the period, inflation rose to 20 percent. In 1958, the government was forced to apply the monetary brakes, and the rate of increase in the money supply was reduced. Inflation nevertheless continued at a fast pace until 1960.

5. Foreign Trade

During 1950-1953, there was a steady rise in exports, but this was accompanied by a sharp rise in the import bill, so that a large deficit on the current

account developed in 1952-1953. At the same time, the inflow of foreign aid also fell; the overall balance was only maintained by a reduction of reserves and increase in short-term supplies and commercial credits. Exports fell sharply during 1954-1958, and failed to return to their 1953 level for the rest of the decade. Imports were also reduced, but the current account was still heavily in the red, and Turkey was faced with a mounting total of foreign debt.

There are a number of factors which explain the foreign-trade fluctuations of the 1950s. In the 1950-1953 period, exports were aided by the surge in agricultural production and in the supply of export goods. However, the decline in the value of exports after 1953 cannot be accounted for by factors which were beyond the control of the Turkish government [Ref. 4:p. 43].

By the end of 1957, external deficits had reached a crisis point. The total foreign debt was at approximately the \$ 1,011 million level.

E. IMPORT-SUBSTITUTION PERIOD AND ECONOMIC GROWTH (1960-1978)

With the implementation of the three five-year development plans, the economy continued to expand throughout this period with unprecedented growth in the manufacturing and service sectors. The growth rate of agriculture, although relatively modest, stayed consistently above that of the population, with an average of 3.3 percent per annum. In the early 1970s, high worker remittances, together with aggressive investment plans of the government, enabled the domestic output to keep on growing for a few more years, until the end of 1976, when the oil crisis threw the economy into a deep recession. Throughout the remainder of the decade, Turkey struggled with severe balance of payment difficulties coupled with rising inflation. By the end of the 1970s, the Turkish economy found itself in an economic crisis accompanied by political instability and social unrest.

Parallel to these negative developments, the economy underwent a far-reaching transformation in its structure during the same period. While the share of agriculture in total output (at 1968 prices) declined from 38.4 percent in 1962 to 23.3 percent in 1977, that of the industrial sector (including manufacturing, mining, energy and construction) rose rapidly from 22.3 percent to 31.5 percent [Ref. 15:p. 2]. Nevertheless, this economic expansion did not give rise to the "expected" outcomes when the results obtained are compared to the international norms of the same period. First, the growth in manufacturing did not succeed in generating adequate employment opportunities to absorb the labor force released by the shrinking agricultural sector. Second, compared to other developing countries in the same income category, the share of agriculture in GNP continued to remain relatively high, which hampered the growth of total factor productivity. Third, in spite of this impressive growth record of output, the share of total gross savings in Gross Domestic Product (GDP) at 1968 prices did not show a substantial improvement and remained stagnant throughout this period (see Table 2.8). Fourth, international comparisons also reveal that exports remained well below those of other developing countries with similar characteristics. There was a continuing dominance of the public sector over domestic industrial production during this period, despite all the incentive programs directed at the private sector.

During the 1960-1978 period, there were two major and interrelated developments in the expansion of the Turkish economy. One is the impact of five-year development plans on industrialization and capital accumulation. The other is the end of the "easy stage"⁸ of import-substitution and the beginning of its "complex

⁸During that period, the domestic production of most consumer nondurables and of their immediate products was achieved utilizing mostly unskilled labor. It came to an end because these products were mostly labor intensive and did not require large-scale production for efficient operations.

stage,⁹⁹ characterized by the replacement of imported intermediate and capital goods, consumer durables, and the domestic production of related technologies. The main thrust of the planning years originated from inward-looking import-substituting programs that relied heavily on public investments in both manufacturing -- through SEEs -- and infrastructure, and resulted in a steady growth of domestic total demand.

Table 2.8. Sectoral Distribution of Investments and Savings

	Growth Rates (%)			Shares in GDP at 1968 Prices (%)			
	1963-67	1968-72	1973-77	1962	1967	1972	1977
Total gross investment	8.5	7.2	15.3	15.8	17.4	17.9	26.1
private	4.8	9.1	13.1	8.6	7.8	9.0	10.5
public	12.5	5.4	18.0	7.1	9.6	8.9	14.6
Total gross savings	12.7	5.2	8.8	12.3	16.4	15.4	16.7
private	11.9	3.6	12.2	6.7	8.6	7.5	9.3
public	13.7	6.8	6.9	5.6	7.8	7.9	7.4

Source: Turkish State Planning Organization

⁹⁹The complex stage of import substitution was a period (1970s) when consumer durables and the production of intermediate and capital goods was at stake. Because the production of these goods depends critically on the implementation of high technology and the use of highly skilled labor, the deficiencies in labor training, technology adaption, and management had very strong negative effects on efficiency and productivity growth.

III. THE NEW POLICY OUTLOOK AND STRUCTURAL CHANGE

A. EMERGENCE OF EXTERNAL PRESSURES (DEVELOPMENTS IN THE 1978-1980 PERIOD)

The Turkish economy ran into a serious foreign-exchange crisis between 1978 and 1980, concomitant with its failure to meet the debt servicing obligations on its outstanding foreign debt. Although the indicators on this debt were moderate, its short-term liabilities aggravated the debt profile. By 1977, its short-term liabilities had come to constitute 57.9 percent of its total outstanding debt.

The negative real interest rates charged by international banks on loans offered to developing countries in the years following the first oil crisis (1973) had served as a pitfall in which a large number of developing countries were entrapped between the end of the 1970s and the beginning of the 1980s.

Because of easy borrowing, Turkey's outstanding foreign debt almost tripled over a period of three years -- from \$4.7 billion to \$13.8 billion between 1975 and 1978. The IMF entered the scene in 1978, drawing up a two-year standby agreement in accordance with its conditionality stipulations but with no success; hence there were no fresh funds forthcoming. Turkey was strangled by a foreign-exchange shortage and was thus gripped with stagnation and shortages of basic necessities. Turkey undertook to reduce public sector deficits, to reduce public sector borrowing from the Central Bank, which meant a ceiling on domestic credit, and to respect limits set on new foreign borrowing. In March 1978, prior to the signing of the standby agreement, a 23 percent devaluation of TL against the US\$ had already been made. This agreement opened the way to debt rescheduling and consolidation negotiations between Turkey and its creditors. By September 1978, it had become evident that Turkey was going to exceed the limits on domestic credit set out in the standby agreement. The appeal by Turkey for a revision of the performance criteria of

standby was accepted by the IMF. Despite this, Turkey was still unable to meet the limits and the agreement lost its force by the end of the year. [Ref. 16:p. 75]

Turkey and the IMF had completely different views regarding failure of the stabilization efforts envisaged by the standby agreement. The Turkish authorities thought that the failure was due to production bottlenecks caused by the import constraints that the economy was facing and the reluctance of the creditor to extend debt relief and new credit to Turkey. The IMF believed that failure was inevitable because the TL was still grossly overvalued and that the government was not really trying to open up the economy. According to the Turkish authorities, the current situation was temporary, caused by excessive short-term borrowing carried out during the 1975-1977 period. If debt relief and new lending were to be extended, Turkey could resume the import substitution strategies in force since the 1960s and a permanent way out of the crisis would be found. The IMF believed that Turkey's problem was the import substitution strategy, and the permanent solution to the crisis was the abandonment of such policies in favor of outward oriented strategies after a period of stabilization. Turkey should immediately begin with institutional and economic reforms to back these outward oriented strategies. [Ref. 16:p. 76]

From the standpoint of oil-importing indebted countries, the following year was marked by a worsening of the conditions in the international market after a new rise in oil prices. Import shortages were more severe and inflation was even higher than in 1978. At this stage, the North Atlantic Treaty Organization (NATO) and Organization for Economic Cooperation and Development (OECD) countries stepped in, and under pressure from these countries, the IMF entered the stage a second time and a new one year standby agreement was signed in April 1979. A 44 percent devaluation was undertaken in June 1979. Debt relief negotiations resumed and fresh funds from the OECD, the European Economic Community (EEC), and the World

Bank became available. This increased availability of funds was insufficient,¹⁰ however, in the face of unprecedented oil price increases along with increases in prices of other imported inputs, output losses and inflation continued. It also became clear that standby limits on domestic credit were going to be exceeded. Turkey succeeded in converting a part of its private short-term liabilities into long-term public liabilities and somewhat stretching out the maturity term of the latter.

Under these circumstances the Suleyman Demirel government took office in November 1979. The economic policies marking the period with 1980 came into effect in the wake of the government's realization that unless Turkey resorted a second time to debt rescheduling, it was doomed to failure in meeting its debt obligations. Unless ample fresh funds were forthcoming, the domestic economy was likely to become unmanageable. As Turkey's creditworthiness had shifted to an all-time low, it could no longer borrow from international banks which had revised lending policies to cooperate with the IMF. [Ref. 17:pp. 336-343]

At the end of this two year process, the main features of which are touched upon above, Turkey had decided to make the adjustments required for a closer integration with the Western economic system, as expounded in the policy advice of the IMF and the World Bank. Western sources of finance had shown their determination not to finance new bursts of development based on "old strategies". Two unsuccessful standby agreements over a period of two years must be viewed against the background of this phenomenon. In the final analysis, Western sources of finance had the final say and Turkey reached the structural adjustment decisions. [Ref. 16:p. 77]

¹⁰Out of the \$989.3 million pledged by the OECD Aid Consortium Countries, only \$253.7 million were disbursed and Saudi Arabia's pledge went unfulfilled.

B. ADOPTION OF A NEW POLICY IN THE ECONOMY

Faced with the most severe economic crisis in the history of the republic, the Demirel government finally realized the need to undertake fundamental reforms that would alter the structure of the Turkish economy. On January 24, 1980, the government initiated a major change in the orientation of economic policy and introduced a major and comprehensive economic stabilization package. Behind the package was Turgut Ozal, a powerful technocrat in the position of Undersecretary of the Prime Ministry. However, even key ministers had been unaware of the scope of the plan outside their own domain; they were asked to sign a variety of decrees and had no advance information as to what other components of the program would be.

The Demirel government drafted this program in perfect recognition of Turkey's constraints and of the revision expected in its policy stance by international creditor. The program's aim was to pledge to the OECD consortium, the World Bank, and the IMF Turkey's intent to implement new policies. Expectations were that their approval would be secured for a new debt rescheduling and the extension of fresh funds. The government thus committed itself to the realization of an outward-oriented, free-market economy at a time when its bargaining power was at its lowest and when it had no other choice but to accept those policies perennially proposed to indebted countries in difficulty. [Ref. 18:pp. 59-81]

Simultaneously, the government entered into negotiations with the IMF and other official and unofficial creditors. Negotiations with the Fund resulted in a three-year standby agreement in June 1980. However, because of the political weakness of the minority government, which was not able to elect a president of the republic after months-long sessions in Parliament, political and economic turmoil continued until the military intervened in September 1980. The military quickly formed a civilian government and put Ozal in charge of continuing the implementation and strengthening the already introduced reform program. Later in 1980, the standby

agreement with the Fund, and in particular the strength of the underlying economic program, helped convince the OECD governments to reschedule principal and interest payments falling due between 1980 and 1983 for ten years. Eventually, in 1981, the banks agreed to extend the maturities of the rescheduled bank debts for a seven year period.

Ozal served as Deputy Prime Minister from September 1980 until a bank and brokerage house crisis in 1982 led him to resign. The military leaders blamed Ozal's minister of finance, K. Erdem, for the crisis. As financial deregulation and interest rate liberalization were the main issues of Ozal's program, he took responsibility and resigned from office [Ref. 7:p. 46].

In 1982, after a rewritten constitution was approved by a vast majority in a referendum, the first general election under the new constitution was scheduled to be held in the spring of 1983. In this election, Ozal's new Motherland Party (MP) won the election with a comfortable majority, and he resumed office as Prime Minister in 1983. He immediately picked up the banner of the January 1980 reform program to push through some major and ambitious additional policy measures. The new Ozal government was determined to attack the sources of the economic crisis where previous attempts at reform had only sought to deal with the symptoms.

Stability was the first and immediate goal. One of the fundamental issues of a free-market economy is the ability to establish and maintain relative price equilibrium. To achieve this goal, it was necessary to remove imbalances in relative prices in the commodity, labor, financial and capital markets. Imbalances in the commodity markets originated largely from the pricing policies of the state enterprises. These imbalances were aggravated by discrepancies and inconsistencies in import regulations. Imbalances in the labor markets derived from policies affecting taxation, income distribution and wages. Finally, imbalances in the financial and

capital markets originated from the extensive state intervention in the financial sector. Moreover, uncertainties in government put an even greater strain on these balances.

Structural transformation was the second goal. As a developing country in need of regaining international credibility, Turkey focused on a program that sought to achieve balance of payment viability over the medium term. The ultimate target of the restructuring was to enter onto a path of self-sustaining growth. Based on these two interrelated objectives, the government's policies were designed to correct distortions, inefficiencies, and supply rigidities in the domestic economy developed during the long years of financial repression by restoring market signals as a principal guide to economic policy decisions. This would also allow rapid adjustment to external developments. The reforms chosen to achieve these goals fall into two categories: institutional reforms and policy-oriented reforms [Ref. 7:pp. 34-59].

1. Institutional Reforms

The governments institutional reforms are aimed at achieving a better, more unified, efficient, coherent, responsive, productive, and timely process of economic decision making and execution throughout the economy, from central government to the State Economic Enterprises (SEEs) to the private sector. Efficient decision making was, before the reforms, one of Turkey's scarcest resources. As a first step, the traditional organizational structure of the Ministry of Finance was broken down and the Treasury Department was subsumed into the Ministry of Finance in 1983. A new Undersecretariat of Treasury and Foreign Trade was created, reporting directly to the Prime Minister's office. In this way, the prime minister consolidated under his direction all the major agencies of economic and financial management.

A new Money and Credit Committee was established to discuss policy issues. The Economic Coordination Council was the corresponding political forum, headed by the prime minister and attended by some of the key ministers and technocrats.

These institutions were considered short-cuts to the long political decision making process [Ref. 7:pp. 43-44].

2. Policy Oriented Reforms

Trade Liberalization: The principal trade reforms included the elimination of quantitative controls on imports, such as the quota and licensing system; replacement of the positive import list¹¹ with a negative list¹²; replacement of nontariff with tariff barriers; and a gradual reduction of levels of protection [Ref. 7:pp. 60-92].

Liberalization of the exchange control regime: The country's conservative and rigid exchange control system dated back to the early years of the republic. Before 1980 a Turkish citizen could be penalized for having a single US dollar in his pocket. With this reform, Turkish citizens are free to open savings accounts in any foreign currency and to transfer funds from these accounts anywhere in the world without restriction. In addition, investors in the Istanbul Stock Exchange may freely move money in and out of the country.

Exchange rates: Reform of the exchange rate policy was one of the key decisions of the reform program. A gradual process of freeing the exchange rate was applied, beginning with mini-devaluations and later moving to daily adjustments, and finally, to market-determined exchange rates.

Export orientation: A new set of tools and institutions were introduced for export promotion. Exporters were allowed to import their inputs at world prices in order to be able to compete worldwide. An export-import bank (Eximbank) was established, and an export insurance scheme was introduced to cover country risks. [Ref. 7:p. 72]

¹¹Which specified those goods that could be imported, with all others proscribed.

¹²Which listed only the imports proscribed, allowing all others.

Financial-sector deregulation and reforms: Freeing of interest rates was the main policy decision aimed at boosting the rate of saving. In a depressed market with negative interest rates, this policy increased monetization of the economy. However, without efficient regulation and supervision, this situation first created an oligopolistic reaction from the banking system and led to a financial crisis when a major brokerage house went under. In the wake of this crisis, financial reforms were institutionalized in a new legislation governing commercial banking, the Central Bank, and the stock exchange and other capital markets. For the first time a deposit insurance system was introduced. Elimination of entry restrictions attracted many foreign banks into Turkey, and this enhanced competition in the sector.

Fiscal reforms: The introduction of a value-added tax in place of nine different taxes was the key reform in the fiscal area. Elimination of price controls applying to both state enterprises and the private sector, and elimination of subsidies in the public sectors were other important achievements.

Foreign direct investment: Although Turkey has had one of the developing world's most liberal foreign direct investment laws since 1954, its implementation was conservative. The bureaucracy's negative effect toward foreign investment was minimized with some new elements which were introduced to attract direct investments.

Privatization: The privatization program, which is still under way, is a necessary element of the new economic policy and part of a wide-ranging program of structural transformation of the Turkish economy. The government's main goal in privatizing its State Economic Enterprises (SEEs) is to make the economy more responsive to market forces. The role of the government is to be confined to areas where the private sector cannot or will not enter because of profitability considerations, or where the services provided are in the nature of essential public

goods.¹³ This policy is not merely a solution to the problems of SEEs; it is also intended to increase competition and productivity throughout the economy.

There are some reasons why the privatization program has not been accomplished. First, the program was slow to get underway. The amount of preparation required was frequently underestimated. Second, the institutional arrangements were unsuitable and inefficient in the early stages. What was needed was a single independent agency with strong political support. With the high unemployment rate, people are not yet convinced of the merits of privatization. Third, the legal system has to be fortified to inspire confidence in international investors. Lastly, the issue of privatization has been overpoliticized. An effort to depoliticize the issue is called for, because the government's vulnerability to political attack is reducing its efficiency and creating problems for the successful implementation of the rest of the economic program.

Infrastructure: The existing infrastructure had no ability to serve the new economic growth program. Energy, transportation and telecommunications investments were given top priority.

C. STEPS OF STRUCTURAL ADJUSTMENT

1. Stabilization (1980-1983)

a. *Economic Policy Tools*

From 1980 until the end of 1985, substantial official credits were extended to Turkey by the IMF, the World Bank and the OECD Aid Consortium Countries.¹⁴ In addition, with the IMF endorsement of the program, Saudi Arabia, the Islamic Bank, the OPEC Fund and the European Settlement Fund also contributed to

¹³Like defense, health care, education and infrastructure.

¹⁴The IMF loaned \$1.2 billion with an additional \$225 million in 1984, the World Bank \$1.6 billion in five structural adjustment loans, and the OECD Aid Consortium Countries \$4.6 billion between 1980 and 1985.

support stabilization package. The yearly average for current-account deficit reached 3.3 percent of GNP while the non-interest current account ran a deficit of the order of 1 percent of GNP. This massive official support had a large effect in the redressal of the economy.

The substantiation of a free-market economy called for a substantial reduction in the government's role in direct productive activity and its intervention in the price mechanism. The government was to confine its economic activity to undertaking infrastructure investments, in particular in energy production. There was to be an overall deregulation in all markets while agricultural price supports, including subsidies to inputs, were by and large to be eliminated.

The inflation rate was to be reduced by strict control of the money supply. The money market was to be regulated so as to permit the formation of positive real interest rates. Direct controls over foreign trade and the foreign-exchange market were to be relaxed. As a first step, the crawling peg system was to be adopted following a substantial devaluation of the Turkish Lira (TL). Additionally, the multiple exchange rates were to cede their first place to a uniform rate, and the clearing agreement with Soviet Union was to be replaced by payments in convertible currencies. The Central Bank was to be conferred as the jurisdiction to run the system. Measures were to be taken for promoting the inflow of foreign direct investments to offset the reduction in domestic investments, and controls over capital inflows were to be lifted. In addition, in order to transform the inward-looking economic structure to an outward-orientated one, other measures -- institutional or monetary -- were to be taken so that exports could expand. Debt management institutions were to be strengthened. [Ref. 19:pp. 165-187]

The foregoing measures brought into effect through a heavy reliance on relative price changes to engender the expected structural transformation in the economy. First, domestic demand was substantially curtailed to bring down the

inflation rate and to promote exports. Domestic terms of trade were shifted against agriculture by way of manipulating agricultural price support policy and imports. Thus, in real terms per capita income in agriculture could be lowered. Labor union rights to strike and employer union rights to lay off workers were suspended, and a militant trade-union federation was banned from activity. In state economic enterprises, wages were brought under control by substituting a so called "Coordination Committee" instead of collective bargaining; the salaries of government employees could be directly adjusted in accordance with requirements via budgetary allocations; the prices of public goods and services were raised so that the supplying state enterprises could reap substantial profits. High positive real interest rates, plus real devaluations, also contributed to the curtailment of domestic demand.

In restructuring the economy towards outward-orientation, the major economic policy tools implemented relied on reductions in income and consumption by social classes making their livelihood out of labor income or, as in the case of agricultural producers of a meager mixed income. The investment rate, however, was sustained at its previous level of around 20 percent of GNP.

Second, the foreign-exchange and trade regimes were substantially liberalized. Instead of the previous officially fixed exchange-rate system, the crawling peg system was introduced in May 1981, based on daily adjustments of the foreign exchange rate by the Central Bank. The commercial banks were to follow this central rate, with rates to be fixed within a narrow band around the former. This system helped eliminate the overvaluation in the TL and reduce the gap between the official rate and the black-market rate through constant adjustments- according to differences in inflation rates at home and abroad, changes in foreign terms of trade, movements in the current account deficit etc. It also permitted the undertaking of ample real devaluations without making it a public issue. In effect, the index of the

real effective exchange rate of the TL declined from 145.3 in 1979 (May 1981=100) to 80.3 in 1983; that is, its value declined by 45 percent in real terms. Tax rebates provided a further incentive to export orientation. In addition, the previous prohibitive approach to imports was altered, even if import liberalization was postponed to the second period.

Third, interest rates were deregulated by mid-1980. However, by mid-1983 this implementation had to be discontinued. This is because of the outbreak of a serious financial crisis in the money market in 1982 which ended in the collapse of a large number of (deposit collecting-money lending) private loan institutions along with some small private banks. The savings of many low-income or middle-income urban savers -- most of them retired persons -- were lost in consequence, causing great hardship. In consequence, centralized control of money markets and the banking system was reintroduced. Nonetheless, the commitment to sustaining positive real interest rates were also observed by official authorities, the Ministry of Finance. Underlying the high positive real interest rates was the strict control exercised by the IMF on the money supply, primarily by limiting credits extended by the Central Bank to the public sector. [Ref. 17:p. 354]

These radical policy alterations lacked a radical tax reform to increase government fiscal revenue. Whatever change did take place in the tax system was orientated to alleviating the tax burden on income from capital and to shifting the burden of taxation from direct to indirect taxes. The policy makers of the military regime had adopted the supply-side economics approach to taxation as a means to boost business activity.

With these policies, significant changes occurred in the functional distribution of domestic net-factor income in favor of capital at the expense agricultural income, as well as income from labor.

b. Performance Indicators of the Stabilization Period

The unique advantages that Turkey enjoyed in the neighboring countries and within its domestic economy, accompanied by economic policy tools, led to a notable improvement in basic performance indicators. Table 3.1 gives data about some performance indicators during the stabilization period.

Table 3.1. Turkish Economic Indicators, 1979-1983

	1979	1980	1981	1982	1983
Real GDP (billions of 1968 TL)	208	206	215	224	232
Growth rate	-0.6	-1.1	4.2	4.5	3.3
Real investment (billions of 1988 TL)					
Private	7.6	6.7	6.2	6.5	6.7
Public	9.9	9.5	10.3	10.6	10.2
Index of industrial output (1986 = 100)	N/A	N/A	65.1	70.3	76.2
Exports (billions of US\$)	2.3	2.9	4.7	5.7	5.7
Imports (billions of US\$)	5.1	7.9	8.9	8.8	9.2
Current account deficit	-3.2	-5.6	-4.5	-3.2	-3.7

Source: [Ref. 7], appendix tables.

First, exports doubled between 1979 and 1983 -- from \$2.26 billion to \$5.73 billion -- notwithstanding the considerable appreciation in the value of the US dollar. The current account deficit -- including 1980 -- hovered around a yearly average of 3.3 percent of GNP, permitting a considerable expansion in imports. This was crucial in view of the import bottlenecks faced in raising manufacturing output prior to 1980. Thus idle capacity in the industrial sector could easily be mobilized, on the other hand, to export expansion creating the required demand for its output and, on the other to import, expansion supplying its inputs. After the drop in manufacturing output in 1979 and 1980, output picked up again and the annual growth rate averaged 7.4 percent, from 1981 through 1983. The performance of

agriculture, however turned out to be quite poor due to a deterioration in its domestic and international terms of trade; its growth rate for the same years averaged out to a mere 0.7 percent per annum. GNP growth, although below the rate in normal years, increased to 4.5 percent per annum between 1981 and 1983. That is, export expansion dragged back an upward growth performance.

When looked at in terms of US dollar estimates, the picture was different; Turkey turned out to be one of the two middle-income countries, together with Argentina, whose per capita income declined by about 7-8 percent in the first half of the 1980s -- from \$1,330 in 1979 to \$1,270 by 1983. Substantial real devaluations, added to the deterioration in Turkey's international terms of trade, worsened the relative income position of the population. Given the large shifts in the functional distribution of income against agricultural producers, as well as wage and salary earners, economic hardship mounted for the majority of the lower-income social classes. It was, by and large, receivers of income from capital, whose share jumped from 38 percent of domestic income in 1978 to 54.7 percent in 1983 who benefited from these policies. Within this group the large industrial conglomerates with a foreign trading company and commercial bank participation were especially favored.

Second, Turkey's outstanding debt profile improved considerably to debt rescheduling. Whereas in 1977 and 1978, 57.8 percent and 52 percent respectively of total outstanding debt consisted of (private) short-term debt, this ratio remained as low as 12 percent until the end of 1983. But the other debt indicators worsened: the debt/GNP ratio jumped from 28 percent in 1980 to 35.6 percent in 1983 because of laggard GNP growth in US dollars and, notwithstanding the substantial expansion in exports, the debt service/exports of goods and services ratio jumped from 22.7 percent to 29.5 percent during the same years. Turkey's total outstanding debt went up from \$14.23 billion in 1979 to \$18.3 billion in 1983.

Throughout this period, Turkey benefited from net resource transfers from abroad; the non-interest current account deficit amounted to 1 percent of GNP which facilitated the attainment of the targets set. The international reserves/imports ratio also improved, increasing from a mere 15.9 percent in 1979 to 22.7 percent by 1983. In consequence, Turkey was able to regain creditworthiness in international markets towards the middle of the decade at a time when, following the outbreak of the debt crisis in Latin America, many developing countries had lost theirs.

Third, there were also substantial achievements in the monetary domain. In the pre-1980 crisis years inflation had accelerated, accompanied first by a decline in the GNP growth rate but finally ending up in a negative growth rate in 1979; in this latter year the wholesale price increase index rose to 60.3 percent while GNP growth dropped to -1.1 percent. This stagflationary trend continued in 1980 with a further rise in prices to 107.2 percent per annum and a further decline in GNP by 2.9 percent. But the shock therapy policies implemented worked efficiently and pulled the inflation rate down to an average of 30 percent per annum, while the GNP growth rate turned positive, at an average of 4.5 percent per annum, between 1981 and 1983. Real positive interest rates helped channel financial savings which, at that time, were mainly deposits in commercial banks. This shift also helped dampen the inflation rate, even though the overall domestic saving rate dropped by a few percentage points.

Finally, some crucial steps were taken towards reducing state intervention in the economy. Price subsidies to state economic enterprises and agriculture were substantially reduced, whereas they were increased for exports of manufactures; price controls, previously exercised on a large number of goods, were either reduced or completely lifted. The foregoing policies did not work smoothly as soon as they were implemented. As the decision making process had become totally centralized, policies went into effect with a trial-and-error methodology and the outcome was an atmosphere of constant change.

2. Liberalization (1984-1991)

a. Economic Policy Tools

The period beginning with 1984 is characterized by efforts to liberalize further the goods, foreign exchange, money and capital markets and to ensure the integration of the economy into regional trading blocks as well as the international economy.¹⁵

Beginning with 1984, the transition to a more liberalized import regime was initiated with the abolishment of the prohibitive approach to imports. Nominal tariff protection was substantially reduced: the arithmetic average of rates dropped from 76.3 percent to 48.9 percent. The outstanding feature of the import liberalization process was the substitution of price levies in lieu of bureaucratic controls and quantitative restrictions. Initially, in order to protect some of the domestic industries, import surcharges played a crucial role together with tariffs and real devaluations. [Ref. 20:pp. 9-36] In 1989 and 1990 both tariff rates and import surcharges were reduced further; however, in early 1992, on the advent to power of the coalition government, both were raised on some specific products to protect domestic productive sectors. By the end of the 1980s and the early 1990s, imports had been liberalized up to a rate of 94 percent. This rendered meaningful the application to the IMF for the endorsement of the convertibility of the TL (Turkish Lira).

The liberalization of imports was followed by reductions of tax rebates on exports because they conflicted with the stipulations of the GATT subsidy code -- of which Turkey is a signatory -- and since they gave rise to fictitious exports. reductions commenced in 1986 and the system was discontinued from 1988. The Eximbank was instituted in 1987 with the purpose of financing foreign operations,

¹⁵Along with associate membership of the European Community (EC) and European Free Trade Association (EFTA), Turkey holds full membership in a number of regional organizations such as the Economic Cooperation Organization, The Black Sea Regional Economic Cooperation Organization, and the Islamic Conference Organization.

and an export insurance system was instituted in 1989 to help reduce exporters' risk exposure.

Liberalization of the foreign-exchange market accompanied the foregoing changes. Residents and non-residents were allowed to open foreign currency deposit accounts with commercial banks by the end of 1985. In 1988 and 1989 the foreign-exchange and gold markets were instituted and capital-account transactions were liberalized. In August 1990 market-determined prices for foreign exchange replaced the Central Bank-determined prices, the system which had been in effect since May 1981.

The foregoing policy changes and institutionalization processes were paralleled by similar moves in the money and capital markets. In the autumn of 1988 the Central Bank freed commercial bank deposit rates; the free setting of non-preferential lending rates had remained in effect since the early 1980s. From April 1986, an interbank money market started operations. In early 1987 the Central Bank initiated open market operations and from 1986 onwards started to prepare monetary programs, targeting M2¹⁶ until 1990 and from then on a monetary aggregate called the "Central Bank money".

The capital-market board had been established as early as 1981 but had remained inoperational. It was only with the institution of the Istanbul Stock Exchange in 1986 that capital market operations became meaningful. The reliance of the government in office on domestic borrowing -- beginning with 1985 -- rather than tax revenue increases to meet budget expenditures fed enough material to keep the market going. In addition, the start of the privatization of public enterprises in 1986, by floating their shares on the market, contributed to the same end. Private corporations, squeezed by high real interest rates on bank credits, followed suit so as

¹⁶Broad money; net of liabilities (to residents and emigrants) denominated in foreign currency; currency and coins, checking deposits, and saving deposits in commercial banks.

to obtain access to cheaper finance. On the liberalization of the capital account transactions, beginning with 1989, foreign portfolio capital inflows were also added to the list. By early 1990s, capital market operations had become a part of daily life.

Turkey had passed a liberal law in the early 1950s to attract foreign direct investments, but the total amount invested until the end of the 1970s remained meager. From the early 1980s measures were taken to ease the red tape associated with the issuing of permits. Furthermore, the revision in the laws related to oil exploration, and to the encouragement of the tourism industry, as well as the government decree encouraging foreign direct investments introduced a much more liberal approach to the operation of foreign capital in the domestic economy. This was furthered by the 1985 law on the establishment of Free Zones in several parts of the country. Free border trade with the neighboring country residents, encouragement of foreign banks to open branches etc. all point to the degree of government commitment to outward-orientation. This policy has also been valid for domestic capital so that Turkish business persons have been undertaking a wide variety of economic activities abroad in a large number of countries.

The liberalization of trade union activity commenced in the last months of the military regime and went into effect on the advent to power of the civilian government in the autumn of 1983. New revised laws for trade unions and collective bargaining were passed, and previously suspended rights of collective bargaining and to strike were restored by 1984. The abolition of coordination committee, however, came later in 1987. From 1988 more freedom was granted to trade unions and real wage increases became the rule.

However, taxation policy continued to remain a lame duck of the policy package implemented in this period. An important step -- in the way of adapting indirect taxes to EC policies -- was taken by putting into effect the value-added tax in 1985 and abolishing outmoded indirect taxes. The tax revision undertaken in 1987

aggravated the tax burden on wage workers and government employees. This was followed by steps to increase the tax burden on income from capital by restoring the withholding tax¹⁷ on interest income from TL, foreign-currency deposits and government internal borrowing papers.

The fact that an increasing surplus on the non-interest current account was targeted by the government implied that the domestic saving rate would have to be raised, in comparison with the previous period, given the investment rate. Additionally, since the burden of foreign-debt servicing fell, by and large, on the public sector, the government would have to be able to lay hands on an increasing proportion of domestic savings. Furthermore, in order to boost economic growth, the government had to sustain public investment but abstain from being involved in directly productive domains. Thus, it had to confine its investment activity to infrastructure in order to abide by its pledge to privatize economic activity.

The domestic saving rate was raised, in part, via real positive interest rates on financial assets and, in part, by the redistribution in income in favor of high income capital owners through inflation and other policies. Since government tax revenue increases -- as a means of forced savings -- displayed an elasticity coefficient around unity with respect to GNP growth, from 1985 domestic borrowing was resorted to in order to transfer a part of increasing private savings to the public sector. Sale of government securities and treasury bonds, by and large to commercial banks, has been the basic means by which this transfer takes place. Together, these changes have endangered three undesirable outcomes which are closely related to each other:

1. high real interest rates (on commercial bank credits),
2. the stepping up of the inflation rate from 1985 onwards, and
3. increasing inequality in income distribution.

¹⁷Abolished in the early 1980s.

b. Performance Indicators of the Liberalization Period

The second period of the implementation of the restructuring program basically may be divided into two subperiods. In the first subperiod, which lasted from 1984 through 1987, most of the economic performance indicators improved compared to the previous period. However, in the second subperiod covering the years 1988 through 1991, not only did they worsen, but there was also extreme financial instability in the foreign exchange, capital and money markets. The surviving economy of the first subperiod ceded its place to a stagflationary process. Table 3.2 states performance of the Turkish economy after 1984.

Table 3.2. Economic Performance after 1984

	1984	1985	1986	1987	1988	1989	1990	1991
Real GNP (trillions of 1985 TL)	26.4	27.8	30.0	32.3	33.5	34.1	37.3	38.0
Change from preceding year (%)	6.0	5.3	7.9	7.7	3.7	1.8	9.4	1.9
Investment (trillions of TL)	4.8	5.8	7.3	8.7	8.4	8.1	10.3	11.1
Exports of goods and services (billions of US\$)	7.4	8.3	7.6	10.3	11.9	11.8	13.0	13.7
Imports of goods and services (billions of US\$)	10.3	11.2	10.7	13.6	13.7	16.0	22.6	21.0
Current account balance (billions of US\$)	-1.4	-1.0	-1.5	-0.8	1.6	0.9	-2.6	0.3

Sources: [Ref. 7], appendix tables; International Monetary Fund, *International Financial Statistics Yearbook 1992*; OECD, *Economic Outlook* (June 1992).

From 1984 through 1987 GNP growth (7.3 percent per annum), saving and investment rates in GNP (20.3 percent and 22.4 percent per annum respectively) and growth rates in agriculture and manufacturing (2.0 percent and 8.9 percent per annum respectively) improved noticeably compared to the previous period. Additionally, not only did the current account deficit -- as a percentage of GNP --

substantially decline (from -3.3 percent to -2.2 percent per annum), but the economy also started to yield a surplus on the non-interest current account. That is, the net resource inflow of the previous period gradually ceded its place to net resource transfers abroad. International reserve holdings almost tripled to meet more than 2.5 percent of yearly imports. There were also substantial improvements on a sectoral basis: the public sector deficit between public savings and investments declined, as a proportion of GNP, while the surplus in the private sector increased.

Export growth rate could be sustained at almost the same rate as in the previous period; exports jumped from \$5.7 billion in 1983 to \$10.3 billion in 1987. However, a part of the increase was fictitious. Export values were inflated to benefit from the tax-rebate system. This fraudulent activity was one of the underlying reasons for the termination of the system by 1988. The composition of exports went on changing in favor of manufactures in the course of rapid export expansion; its share reached 79.2 percent in 1987, compared to 63.9 percent in 1983.

On the other hand, some important indicators considerably worsened. First, some foreign debt indicators reached all-time peaks: the foreign debt/resource ratio¹⁸ almost doubled -- from 24.8 percent in 1980 to 35.6 percent in 1987; second, the real effective exchange rate of the TL went on deteriorating and the index dropped to 64.5 (May 1981=100) by 1987 from 80.3 in 1983; third, the average annual rate of inflation jumped from 31.1 percent in the previous period to 41.5 percent. The persistent worsening of income distribution, despite a considerable improvement in the performance of the economy and in some basic indicators as well as the ongoing democratization process, was perhaps the most striking feature of this subperiod. The change in the shares of agriculture, wages and salaries as well as capital income in the functional distribution of net domestic product followed the same trend as in the previous period; that is, about 85 percent of the active population hardly benefited

¹⁸The foreign debt/resource ratio is a weighted average of the debt GNP and debt service/export ratios.

from the improvement in economic performance. The share of capital income went on climbing relentlessly and claimed 62.2 percent of net domestic factor income by 1987. Inadequate domestic demand turned out to be crucial factor curtailing private investments and manufacturing output in the following years. The economy had been choked by high real devaluations, high real positive interest rates and sharp drops in the real incomes of the majority of the working population.

Beginning with 1988, the economy entered a stagflationary stage and most of the performance indicators started to deteriorate. Some exogenous factors were added on to the endogenous factors and worsened economic conditions in the domestic market. For two successive years, substantial surpluses in the current account of approximately \$1.6 billion in 1988 and \$1.0 billion in 1989 involved considerable net resource transfers abroad; the ratio of non-interest current account surplus to GNP attaining 6.2 percent and 4.9 percent respectively. Seemingly, stagflation plus the heavy deterioration in income distribution and these surpluses were two facets of the same process. The index of real effective exchange rate of TL, which hit a rock bottom value of 62.5 (May 1981=100) in 1988, was permitted to appreciate in the foreign exchange market in the following year to ease the pressure on available resources. The index went up to 68.2 with a substantial inflow of foreign direct investments and portfolio capital: \$1.5 billion in 1988 and \$2.25 billion in 1989. The current account surpluses, plus capital inflows, permitted to repayment of a part of short-term debts, while the appreciation in the TL permitted to a drop in the debt/resource ratio: the former came down to 14 percent of total outstanding foreign debt and the latter to 42.5 percent.

Performance indicators, other than those pertaining to the current account and foreign debts, considerably worsened in these two years: exports stagnated at around \$11.6 billion, GNP growth dropped to 1.5 percent and 0.9

percent, while the inflation rate almost doubled to 75.4 percent and 68.8 percent in 1988 and 1989 respectively. Both agriculture and manufacturing stagnated.

In 1990, policies were revised to reduce the rate of inflation and to ease pressure on available resources. The TL was allowed to appreciate in value further through promoting capital inflow by sustaining a high real interest rate through monetary restraint. The real effective exchange rate index of the TL went up to 76.5, the inflation rate dropped to 60.4 percent, GNP growth rose to 9.2 percent; so did growth rates for agriculture and manufacturing while employment expanded. Notwithstanding the appreciation in the TL, exports also expanded by 10 percent, reaching \$12.96 billion. Income distribution, beginning with 1989, started to turn in favor of wages/salaries as organized labor pressed for high wages: the share of this factor income, after the dip in 1988 (18.2 percent) reached 21.7 percent and that of agriculture 18.9 percent, while the share of capital income dropped to 59.4 percent of net domestic capital income.

The foregoing improvements were obtained by an unsustainable deficit in the current account: this reached 3 percent of GNP while the non-interest current account surplus dropped to 0.7 percent. But with the appreciation of TL, the debt/resource ratio came down to 36.7 percent.

In 1991, performance indicators reverted to their 1988 and 1989 values; that is, GNP growth rate dropped to around 0.3 percent, the inflation rate went up to 71.4 percent and the public sector deficit reached an all-time high of 10.5 percent of GNP. The functional income distribution continued its amelioration in favor of wages and salaries -- 23.6 percent of net factor income -- but this time it was agriculture which lost its share (16.9 percent). The appreciation in TL in the foreign exchange market ceded its place to a small real depreciation, and the deficit in the current account gave way to a surplus; exports expanded by 7.6 percent while imports

contracted by 5.9 percent. The non-interest current account surplus is expected to be around 3.5 percent of GNP and that of the current account around 1 percent.

The picture drawn of the subperiod 1988-1991 leads to the conclusion that economic policies ran into difficulties in striking internal and external equilibrium at one and the same time. It seemed that the one could be ensured only at the expense of the other.

The following tables give detailed information about some variables of the Turkish economy in the 1980s. These tables may create a better understanding of the consequences of the economic reforms of the period.

Table 3.3. Economic Policy Indicators for the 1980s

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990 ^a
Nominal exchange rate (TL/US\$)	76	111	163	225	367	522	674	857	1,422	2,121	4,168
GDP deflator (% change)	104	42	28	29	51	41	30	39	66	65	59
Real exchange rate ^b	432	432	488	509	527	522	505	499	512	473	473
Nominal interest rate	30	36	36	36	55	62	62	66	87	85	65
Real interest rate	-89	-5	4	1	2	9	18	13	-14	-16	7
Real government expenditures (% of GDP)	25	23	18	23	21	19	21	22	21	23	24
Fiscal deficit (% of GDP)	4.0	2.6	1.7	2.6	5.3	2.8	3.6	4.4	3.8	4.4	4.1

Sources: [Ref. 7], rows 1 and 3 from table 9; row 2 from table 12; row 4 from table 16; and row 5 from data appendix, table 10. Rows 6 and 7 from Central Bank of Turkey, *Annual Reports* (1987, 1989, 1991).

^aData for 1990 are not always comparable to those for earlier years. Most are derived from International Monetary Fund, *International Financial Statistics*, and the percentage changes from 1989 and 1990 were linked to the data from earlier years.

^bThe real exchange rate was calculated as the nominal exchange rate deflated by the Turkish wholesale price index and adjusted for the price level of Turkey's Group of 7 trading partners.

Table 3.4. PC Income in Turkey

Years	PC Income US\$
1970	365
1983	1077
1985	1066
1988	1318
1990	1964

Source: State Institute of Statistics

Table 3.5. Average Annual Growth Rate in GNP, Consumer Price Index Agriculture and Manufacturing (%) (1978-91)

Years	GNP (%)	CPI (%)	Agriculture (%)	Manufacturing (%)
1978-80	-0.5	70.2	1.9	-2.3
1981-3	4.5	31.1	0.7	7.4
1984-7	7.3	41.5	2.0	8.9
1988	1.5	75.4	7.9	1.6
1989	0.9	68.8	-7.4	2.9
1990	9.7	60.4	8.2	9.7
1991	0.3	71.4	-1.5	2.3

Source: State Institute of Statistics, national accounts data in constant 1987 prices and consumer price index series

Table 3.6. Outstanding Foreign Debt (\$ million), Debt/GNP, Debt Service/Exports and Gross Foreign Exchange Reserves (\$ million) (1977-1991)

Years	Foreign debt (\$ million)	Debt/GNP (%)	Debt service/exports (%)	Forex gross reserves (%)
1977	10886	--	--	727
1978	14681	--	--	902
1979	14620	--	--	795
1980	16227	28.0	22.7	1308
1981	16861	28.6	21.4	1571
1982	17619	32.8	26.4	1873
1983	18385	35.6	29.5	2098
1984	21258	41.5	27.0	3099
1985	25349	48.1	32.9	2615
1986	31228	55.6	33.8	3187
1987	38304	59.3	36.4	3959
1988	37694	58.0	40.4	5228
1989	40282	51.5	36.7	7762
1990	49035	45.0	31.2	10349
1991	49210			13148

Source: The Central Bank of Turkey and State Institute of Statistics

N.B. Exports cover exports of goods and services. Reserves include reserves with the Central Bank and commercial banks

Table 3.7. Sources of the Increase in External Debt (1980-90)

Items	Share (%)
Current account deficit	27.4
Forex reserve increase *	26.0
Change in cross-currency rates **	26.1
Debt restructuring ***	10.5
Lending abroad	6.4
Errors and omissions in the balance of payments	3.5
	100.0
Increase in external debt (\$ billion)	33.2

Source: The Central Bank of Turkey

* Excluding gold

** Including the World Bank pool differences

*** Conversion of FMS high-interest rate credits into commercial loans with lower interest rates and postponement of interest payments on OECD loans

**Table 3.8. Nominal and Real Effective Exchange Rate of TL,
Exports and Exports/Imports, Exports/GNP (1978-91)**

Exchange rate of TL			Exports		
Years	Nominal TL/\$	Real effective (Weighted)	(\$ million)	(%) ratio to GNP	(%) ratio to Imports
1978	25.0	128.7	2288.2	4.3	50.0
1979	35.0	145.3	2261.2	3.4	44.6
1980	88.9	103.9	2910.2	5.0	36.8
1981	129.6	97.8	4702.9	8.1	52.7
1982	185.1	85.2	5746.0	10.7	65.0
1983	274.0	80.3	5727.9	11.2	62.0
1984	432.5	75.8	7133.7	14.8	66.3
1985	567.9	64.3	7958.0	16.1	70.2
1986	755.2	64.9	7456.6	12.8	67.2
1987	999.2	64.5	10190.0	15.2	72.0
1988	1794.8	62.2	11661.8	16.4	81.4
1989	2304.4	68.2	11624.7	14.8	73.8
1990	2951.1	76.5	12959.5	12.0	58.1
1991	3795.8	75.6	13672.0	13.0	63.6

Source: The Central Bank of Turkey and the State Institute of Statistics.

N.B. The real effective exchange rate of TL is the weighted average with US dollars assigned a weight of 75% and DM a weight of 25%; the base date of the index is May 1981.
Exports and Imports refer to merchandise trade only.

**Table 3.9. Current Account and Non-interest Current Account
Balance and Basic Balance (Average Annual) (1977-91)**

CA balance			Non-Interest CA balance		DI plus portfolio I	Basic balance
Years	(\$ million)	in GNP (%)	(\$ million)	in GNP (%)	(\$ million)	(\$ million)
1977-9	-1939	--	-1333.0	--	45	-1894
1980-3	-2054	-3.3	-641.0	-1.0	54	-2000
1984-7	-1180	-2.2	784.3	1.3	218	-962
1988	1596	2.3	4368.0	6.2	1532	3128
1989	961	1.2	3868.0	4.9	2249	3210
1990	-2625	-3.0	653.0	0.7	1247	-1378
1991	272	0.5	3702.0	4.5	1431	1703

Source: State Institute of Statistics, State Planning Organization, The Central Bank.

CA: Current account

DI: direct foreign investment

Portfolio I: portfolio investment

**Table 3.10. Total Domestic Saving and Investment Rates,
Foreign Saving Rate, Private and Public Investment --
Saving Balance Rates (as % of GNP) (1978-90)**

Years	I _t (%)	S _d (%)	S _f (%)	I _{pr} -S _{pr} (%)	I _{pu} -S _{pu} (%)
1978-9	18.4	16.0	-2.4	3.1	-5.5
1980-3	20.8	17.1	-3.6	0.2	-3.8
1984-7	22.4	20.3	-2.1	0.9	-3.0
1988	24.0	26.3	2.3	4.4	-2.1
1989	22.4	23.6	1.2	4.7	-3.5
1990	25.2	22.8	-2.4	4.5	-6.9

Source: State Planning Organization.

I_t: total domestic investment rate yearly.

S_d: total domestic saving rate yearly.

S_f: foreign saving flow rate (minus sign shows inflow, plus sign outflow) yearly.

I_{pr} and S_{pr}: private investment and saving rate yearly.

I_{pu} and S_{pu}: investment and saving rate yearly.

**Table 3.11. Share of Agriculture, Wages-Salaries and Others in
Net Domestic Factor Income (%) (1976-91)**

Years	Agriculture (%)	Wages-Salaries (%)	Others (%)	Total (%)
1976-7	30.2	34.8	35.0	100.0
1978-9	25.5	34.0	40.5	100.0
1980-3	22.3	24.8	52.9	100.0
1984-7	19.8	18.3	61.9	100.0
1988 (*)	18.5	17.4	64.1	100.0
1989 (*)	17.6	20.5	61.9	100.0
1990 (*)	18.9	21.7	59.4	100.0
1991 (*)	16.9	23.6	59.5	100.0

Source: [Ref. 21:p. 6], Table 2

(*): Provisional estimates.

N.B.: Others column covers interest, profit, rent and the income of the urban self-employed

Table 3.12. Money Supply and Credit, 1979-91 (end of year; billions of TL)

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Money supply (M4)	610	1,074	2,143	3,178	3,984	5,941	9,209	13,152	19,132	29,736	50,054	76,782	123,694
Currency and sight													
Time deposits	88	186	690	1,272	1,393	3,045	5,120	6,919	9,020	15,884	27,582	40,173	70,326
Total (M2)	556	924	1,710	2,679	3,477	5,493	5,540	12,276	17,702	27,195	47,142	71,571	117,120
Central bank deposit	144	267	673	866	993	1,279	1,630	1,760	2,371	5,343	8,653	9,947	15,031
Foreign liabilities	199	646	829	1,194	2,129	4,062	6,930	11,955	23,044	38,621	48,564	65,051	113,300
Foreign exchange deposits									1,884	2,926	4,398	5,429	8,034
Central bank lending	382	655	926	911	1,234	880	1,300	1,828	3,439	5,142	6,699	8,294	19,888
Treasury	92	189	262	266	339	528	795	1,052	1,407	2,082	2,565	2,901	13,589
Public enterprise	123	178	233	257	251	37	122	213	763	1,082	1,322	1,565	5,420
Banks	121	240	377	321	569	278	333	479	1,124	1,500	2,200	2,436	3,395
Commercial bank deposits	434	767	1,545	2,384	3,109	5,007	8,038	11,750	17,109	26,209	43,244	66,155	93,219
Commercial bank lending													
Industry	156	283	459	557	526	861	1,722	2,517	3,651	4,233	5,292	8,369	12,815
Agriculture	83	146	266	335	512	530	956	1,782	2,956	4,521	7,404	13,150	18,436
Foreign trade and													
Housing and construction	17	19	42	71	130	250	594	1,330	2,693	4,127	5,571	8,658	10,255
Domestic trade	47	75	148	284	482	560	910	2,049	3,450	4,961	9,634	19,612	30,759
Unclassified	92	170	213	21	38	64	127	118	240	397	555	1,749	3,308
Total	446	790	1,319	1,806	2,418	3,149	5,568	10,053	16,034	22,771	37,050	65,648	102,240
Annual growth rates													
Money supply (M3)	76	100	48	48	25	49	55	43	45	55	68	53	61
Total (M2)	66	85	57	57	30	58	55	44	44	54	73	52	64
Central bank deposit	85	152	29	29	15	29	27	8	35	125	62	15	51
Central bank lending	71	41	-2	-2	35	-29	48	41	88	50	30	24	140
SEE borrowing													
Commercial bank													
Borrowing	98	57	-15	-15	77	-51	20	44	135	33	47	11	39

Source: Central Bank of Turkey

IV. ASSESSMENT OF REFORMS AND THEIR SUSTAINABILITY

A. CONSEQUENCES OF STRUCTURAL ADJUSTMENT POLICIES

Structural adjustment policies (SAP) have been in effect for twelve years (1980 through 1991), thus making possible a realistic evaluation of their outcomes. Turkey has been depicted as a highly successful example of the transition to a free-market economy via the SAP.

1. Favorable Outcomes

The first point to emphasize is that the most notable achievement of SAP is that lately it seems to have solved Turkey's perennial foreign-exchange problem. New export sectors have evolved, and some of the existing industries have become export-oriented; import bottlenecks no longer hamper economic growth; and debt servicing proceeds without disruption.

Second, the economy has been further integrated into international markets through an enlarged foreign-trade sector. Additionally, many service industries have expanded such as tourism, transportation, and contracting. The spirit of globalization is well established in large companies, they began to form key relations with foreign companies both at home and abroad. That is, the Turkish economy has been able to orientate itself in the direction of the world economy at large and has been able to keep pace with the other semi-industrialized countries in attempts to globalize their activities. In this sense, the Turkish economy has become a contemporary economy.

Third, greater international integration, plus market-determined prices at home, have invoked greater cost consciousness in business executives; an enhanced entrepreneurial spirit characterizes the younger generation who, unlike their risk-averse predecessors, stand ready to take risks at home and abroad. People have come to assume greater responsibility for their own welfare. Similar change is observed in the attitudes of policy makers who have become driven more by concerns of economic rationality than before.

Fourth, policy makers have exploited efforts to develop the basic market institutions with the pressures created by the implementation of the SAP. Such key prices as the interest rate and the foreign-exchange rate are now determined by market forces, rather than government rule, as the requisite institutions have been created.

Finally, these favorable changes have been accompanied by non-negligible increases in per capita income, with the discontinuation in real devaluations and the 20 percent appreciation in the external real effective value of the TL after 1987.

These favorable changes in the economic domain, as well as in individual attitudes, have been engendered by the direct and indirect effects of the SAP during the period.

2. Failure with Macro Reforms

Despite these successes, however, the macro reforms were in difficulty. The major problem was that government expenditures increased beyond the ability of the government to increase tax collections. Government expenditures were growing more rapidly than GNP, despite its rapid growth. This is reflected in the rising share of government expenditures in GNP shown in Table 4.1. This increase in expenditures took place despite the repression of civil servant salaries and the virtual elimination of SEE deficits as a budgetary drain (at least until the 1990s). The major increases in expenditures were on infrastructure and interest on the debt, on a fairly sustained basis, and on transfer payments prior to each round of elections. This is reflected in Table 4.1, which gives data on government expenditures and their composition. As can be seen, interest payments constituted only 4 percent of government expenditures in 1981 and had risen to more than 20 percent by the late 1980s. Investment expenditures rose absolutely and as a share of total expenditures until 1987, and fell

Table 4.1. Consolidated Budget, 1979-91 (billions of TL)

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991*
Expenditures	613	1,110	1,503	1,575	2,613	3,785	5,263	8,160	13,043	21,447	38,871	68,527	129,345
Current	262	497	645	720	1,069	1,488	2,086	3,051	4,538	7,460	16,660	33,452	60,900
Investment	95	170	310	344	503	677	989	1,619	2,642	3,564	5,818	10,055	16,600
Transfers	256	443	481	434	831	1,179	1,514	2,159	3,598	5,445	8,134	11,054	27,723
SEEs	83	153	214	233	292	275	181	138	446	1,025	1,223	1,257	11,200
Interest	N/A	N/A	67	87	210	441	674	1,330	2,266	4,978	8,259	13,966	24,122
Revenues	526	933	1,330	1,424	2,314	2,806	4,476	6,754	10,445	18,687	31,369	56,753	97,000
Taxes	406	750	1,191	1,305	1,934	2,372	3,829	5,972	9,051	14,232	25,550	45,399	78,650
Nontaxes	120	183	139	119	380	434	647	782	1,394	3,355	5,819	11,354	18,350
Deficits	87	177	173	151	299	979	787	1,406	2,598	3,860	7,502	11,774	32,345
Net domestic borrowing	31	17	50	28	167	137	498	476	896	2,433	5,982	7,942	1,812
GNP	2,200	4,435	6,555	8,722	11,552	18,375	27,789	39,310	58,565	100,582	170,412	287,254	454,838
% of total expenditures													
Current	43	45	43	46	41	39	40	37	35	35	43	49	47
Investment	15	15	21	22	19	18	19	20	20	17	15	15	13
Transfers	42	40	32	28	32	31	29	26	28	25	21	16	21
SEEs	14	14	14	15	11	7	3	2	3	5	3	2	9
Interest	N/A	N/A	4	6	8	12	13	16	17	23	21	20	19
% of total revenues													
Taxes	77	80	90	92	84	85	86	88	87	81	81	80	81
Nontaxes	23	20	10	8	16	15	14	12	13	19	19	20	19
Ratios													
Government													
Deficit/revenue	17	19	13	11	13	35	18	21	25	22	24	21	33
Deficit/GNP	4.0	4.0	2.6	1.7	2.6	5.3	2.8	3.6	4.4	3.8	4.4	4.1	7.1

Sources: for 1979-80, State Planning Organization, *The Development before the 5th Development Plan*; for 1981-82, Central Bank of Turkey Annual Report, 1985; for 1983, Central Bank of Turkey Annual Report, 1987; for 1984-86, Central Bank of Turkey Annual Report, 1989; for 1987-91, Central Bank of Turkey Annual Report, 1991. The numbers in Central Bank of Turkey annual reports are based on Undersecretariat of Treasury and Foreign Trade provisional numbers.

*Provisional numbers.

thereafter, while transfers fluctuated with the proximity to elections. Simultaneously, tax revenues were growing more slowly than income.¹⁹

There is no mystery as to why inflation persisted. Throughout the 1980s, monetary expansion continued and by all estimates, was the crucial determining factor in the inflation rate. Financial liberalization, and in particular the moves toward full convertibility of the Turkish Lira, led to some currency substitution: whereas the ratio of M2 to GNP fell from .224 to .203 over the 1984-1990 period, the ratio of M2 plus foreign exchange holdings of Turkish nationals rose from .231 to .253 over that period. The Central Bank tried to use a variety of instruments to curb inflation, but was essentially powerless to do so in the face of the financing needs of the government budget.²⁰ In 1991, the OECD provided reduced form econometric estimates of the inflation rate and the differences between the government deficit and the effect of output growth on base-money demand. According to those estimates, over 70 percent of the variability in underlying inflation in Turkey could be explained by the monetization of public sector deficits.²¹

Until the late 1980s, the association of prospective elections with successive periods of inflation was evident to all, and there was some credibility to the notion that government expenditures would be contained "after the election." By the late 1980s, however, it was apparent to all that the support for Prime Minister Ozal and the Motherland Party was weakening, and that there was little prospect that

¹⁹The imposition of the value-added tax in 1985 was judged a great success and yielded more revenue initially than had been anticipated. However, in order to improve incentives, the Ozal government had reduced very high marginal tax rates and corporate tax rates. The net result was that tax revenues did not rise proportionately with income. In [Ref. 22], a logarithmic regression of tax revenues on GNP for the period from 1980 to 1991 has been analyzed. In this study, it is estimated that the elasticity of tax revenues with respect to real GNP growth for the entire period is 0.84.

²⁰In order to investigate whether inflation caused money creation or conversely, see [Ref. 22] for more statistical and analytical information.

²¹See also [Ref. 23], which provides a rationale for such an estimation procedure.

government budgetary discipline could be relied upon to bring about a significant reduction in the rate of inflations.

When new elections in 1991 returned Suleyman Demirel to the Prime Minister's office leading a coalition government, the earlier problems intensified. The fiscal deficit increased sharply as, among other things, the SEE drain on the government budget increased sharply.

3. Some Additional Dilemmas

Exchange-Rate Policy: on the exchange rate, the government's policy has been to achieve a trend toward real depreciation. An occasional real appreciation aside, the real exchange rate has indeed depreciated steadily during the period. The policy had an important effect on top of its direct effect of rendering exporting and import-substituting more profitable.

It is difficult to see why the need for a policy of real depreciation should persist almost an entire decade. There are many costs imposed by continuous real depreciations. First, in an economy like Turkey's, they tend to depress real wages. Second, they tend to keep real interest rates higher domestically than abroad. Finally, they tend to increase the real burden of the public sector's external debt.

Judging by the behavior of market participants, and by the absence of substantial premium in the black market, the path of the nominal exchange rate appears sustainable in the short run. Controlling inflation via the exchange rate is a risky business over the medium to the longer run. In the absence of sufficient fiscal cut, consistent with lower inflation brings two outcomes; continued real appreciation, with damaging consequences for the export drive and real activity; and a sudden collapse of the exchange rate, creating an upward pressure on inflation. [Ref. 23:p. 346]

Investment in Manufactures: one of the surprising features of the export boom, which is largely based on manufactures, is the absence of an underlying investment

drive. Public investment in manufacturing steadily declined after 1980. This was consistent with the redirection of public capital formation towards areas that do not compete with the private sector, such as infrastructure. The expectation was that private manufacturing investment would eliminate this fall once the economy started growing. But this expectation has been failed. In 1988, total manufacturing investment still stood at only two-thirds of its level in the peak year of 1977.

The reasons for this disappointing performance are not entirely clear. An important part of the explanation can be addressed to the atmosphere of macroeconomic instability. Both inflation and the real interest rate have been quite variable. Additionally, manufacturing investment is quite sensitive to uncertainty in these variables. This discourages investment not only through its effect on the cost of capital, but also through its negative impact on the balance sheets of big firms. Trade policy has aggravated the environment of uncertainty by giving inconsistent signals, such as import duties and export subsidies that have been frequently manipulated. Investors focused on the comparatively safe sector of housing [Ref. 23:p. 347].

Income Distribution: Table 4.2 shows the information of the redistribution that has taken place since the late 1970s. In 1988, the real wage and the agricultural terms of trade stood at barely over half their 1973 levels; meanwhile, aggregate per capita income had increased more than a third. This has gone alongside a rather striking realignment of factor shares in national income. Agriculture's share has fallen from 24 percent (1980) to 16 percent (1988). The share of wages and salaries has gone down from 27 percent to 14 percent. Fiscal cuts become more difficult when major popular sectors already feel that they have paid more than their due. Public sector wage settlements have also come under similar pressures during the period [Ref. 23:p. 349].

Table 4.2. Distributional Indicators (1973 = 100)

	Real per capita GNP	Agricultural terms of trade	Real wages
1973	100.0	100.0	100.0
1974	104.7	90.5	97.7
1975	110.1	105.5	105.4
1976	116.4	112.8	121.7
1977	118.5	117.0	124.2
1978	119.4	96.3	122.6
1979	116.5	78.4	101.5
1980	112.9	69.8	72.2
1981	114.4	69.3	64.8
1982	116.2	63.2	64.6
1983	116.9	61.2	67.3
1984	120.2	63.7	61.0
1985	124.9	58.9	54.8
1986	131.3	56.5	54.4
1987	131.8	60.8	55.1
1988	139.2	54.1	54.6

Source: [Ref. 23].

4. Reasons for Successful Sectoral and Failed Macro Reforms

There is little mystery remaining as to why there was inflation in Turkey. The interesting questions center on how the sectoral reforms could have succeeded, at least initially, while the macro reforms were unable to stabilize the economy, and how macroeconomic instability has affected, and will affect, the sustainability of the sectoral reforms.

Three major factors probably account for the success and durability of the sectoral reforms during the 1980s:

1. there was the evident failure of earlier economic policies;
2. there was the personality, determination, and control of Prime Minister Ozal; the personality and commitment of Ozal can not be doubted. Not only did he believe in changing the role of government in the economy, he believed it was the achievement for which history would remember him. In that sense, it was at the top of his agenda and received his personal attention;
3. there was the initial success of the sectoral reforms in bringing about evident changes.

If those factors account for the sustainability of the sectoral reforms, at least through the late 1980s, why were the macro reforms less successful? The primary reason was that the government was unable to increase revenues or reduce expenditures in ways that would permit the Central Bank to break the growth of the money supply more than it in fact did. The question, then, is why the government's fiscal pasture remained so expansionary.

That answer, too, has several parts:

1. there is the personality of Prime Minister Ozal. There seems to be little doubt that, committed as Ozal was to shifting toward more reliance on the private sector for economic growth, he was also an engineer and, perhaps due to this, a builder. He attached less weight to the goal of combating inflation than he did to the goal of resuming and accelerating growth with more efficient allocation of resources and reliance on the private sector;
2. there was some genuine infrastructural problems that needed to be addressed if the private sector was to be able to expand in accordance with Ozal's blueprint;
3. most important, however, were the political constraints imposed on the Motherland Party (MP) in its attempt to maintain power. The fact is that Ozal's support was weakening, and in an effort to retain power, he apparently perceived little option but to increase expenditures in the hope of gaining support. In the end he was unsuccessful, but the new coalition government that followed found the imperative to increase government expenditures even more compelling, and inflationary pressures intensified.

B. SUSTAINABILITY OF THE REFORMS

From the debt crisis, which has plagued much of the Third World since the early 1980s, Turkey has emerged as the "paragon of export-led growth" and an inspiring example of stabilization and liberalization. In sharp contrast to Latin American countries, its rapid gradual recovery of health made it possible to restore its creditworthiness in international markets and regain relatively high growth rates. This can be expressed as "life after debt" [Ref. 24:p. 161]. After more than a decade of economic stabilization and structural adjustment, however, it is possible to argue that the results of these programs left much to be desired. Thus, it is not intended to suggest that the problem has only one dimension. Any attempt at reform has to be considered within the context of the underlying economic and financial policies and the developments from which the crisis has emerged.

When the country's domestic considerations are coupled with volatile international interest and exchange rates, the problem of stabilization, and especially of an external debt overhang, becomes rather unmanageable. It was such a combination that led developing countries in the 1980s to find themselves faced with capital outflows when they needed fresh inflows. Therefore, a significant reduction in the volatility of international interest rates and exchange rates should be considered crucial in achieving a workable set of measures to deal with the problem of sustainable stability and adjustment.

Without the restoration of more favorable terms of trade for the developing countries, a sustained improvement in the access of the developing world's exports to the markets of industrialized countries, and an increasing level of private direct investment, all efforts of the developing countries to design and implement a coherent stabilization program are bound to be short-lived, as well as politically and economically unbearable.

The 1980s undoubtedly had witnessed unprecedented and, even more importantly, irreversible changes in the Turkish economy. Nearly 70 years after the foundation of the republic, Turkey can gradually, at last, look forward to both healthy and sustainable free-market oriented growth and a gradual integration of the Turkish economy into the European Community (EC) and the world economy.

Starting from this background and these expectations, the October 1991 elections led a peaceful transition of government, confirming the growing maturity of Turkey's parliamentary democracy. This was followed by the relatively smooth formation of a coalition between Demirel's center-right and head of Socialist Populist Party Erdal Inönü's center-left parties. This coalition was followed by another coalition with the same parties under the Prime Ministry of Tansu Ciller, and now a new coalition after the election of December 1995 under the Prime Ministry of Mesut Yilmaz (Head of Motherland Party). All these coalitions faced increasing business skepticism about their economic record. Growth may be higher than in most countries, but inflation, still has remained a thorn in the economy's side and all coalitions' economic programs can be criticized both for its content and the slowness of its formulation. The irony is that this slow progress in carrying out election promises in line with the previous reform program is due more to a lack of commitment to those promises than to the delays inherent in governing through a wide-based coalition.

In fact, as we look through each coalition, the structure of the coalition inspired in many circles exactly the opposite expectation with respect to the speed and efficiency of government performance on major social, political and economic issues. Therefore, it appears that, having missed the honeymoon period for action, the current government must come up with a plan to restore the lost momentum. The most vital point in the search for a new set of complementary policies is to fill the gaps in the previous program and fine tune it. The new government also has to review the policy

instruments and institutions in place, since some of those employed in the 1970s and 1980s are no longer valid in the context of the 1990s.

The most noticeable characteristic of the 1980 economic program was its accurate diagnosis that one of Turkey's scarcest resources was neither foreign exchange, nor savings, nor labor, but rather an efficient mechanism for making macroeconomic decisions. The efficiency, speed, and flexibility imparted to the previously inert policymaking mechanism by such institutions as the Money and Credit Board and the Economic Coordination Committee go a long way toward accounting for the program's success up to 1985-86. Clearly it is first priority today to get this decision making mechanism functioning properly again, as it has been deteriorating since 1987. This deterioration accelerated in 1989 when Turgut Ozal assumed the presidency. Similarly, the extrabudgetary funds introduced as an institutional reform have lost their original target of allocative efficiency in public funds and have become the major source of the financial disarray. The foreign trade regime has been increasingly liberalized over the past decade. As there is no question of reverting to the quota system or export incentives in the form of tax refunds, the time has come to liberalize the system still further, avoiding unfair competition through the objective and effective implementation of antidumping and antitrust regulations, while simultaneously expanding export-import bank lending and export insurance services. Recent arrangements with the European Free Trade Association and commitment to integration with the European Community (EC) in the form of a customs union in 1996 are the right steps taken in this area.

To capitalize on these developments, Turkey has to develop its own export markets, using new opportunities and intensifying its efforts such as the Black Sea Economic Cooperation and closer ties with the new republics in Eastern Europe and the former Soviet Union. Easily accessible markets like those in the Middle East in the early 1980s no longer exist. It is also crucial not to overemphasize the role of the

monetary authority and monetary policy in Turkey's export-led market orientation. In fact, since 1980, monetary policy has had to be concerned with both domestic stability and the balance of payments. This means that more support from the fiscal side is urgently needed. Otherwise the Central Bank's credibility will be at risk for an unintended cause. New and consistent macroeconomic policies, as well as better coordination in their implementation is required to restore and sustain credibility, and thus to achieve steady growth under conditions of price stability.

Foreign exchange regulations and policies have been deregulated to the point of no return, and integration with international markets is on the way. Consequently, the response to developments on foreign markets should not be to resort to artificial amendments and interventions such as exchange controls, but rather to adjust domestic economic policies, fiscal and monetary, to eliminate differences in inflation rates between Turkey and its trading partners. A realistic exchange rate policy is a tool for balance of payments adjustment, not for inflation control. It is also particularly important that the Turkish financial markets, which have been integrating with international financial markets since 1980, continue to do so and keep up the process of self-renewal.

As the market economy has taken root, the public authorities can achieve economic development and combat inflation, this is the inevitable outcome of building a free-market economy. Against this limitation on the options available to policymakers, there is an important positive side of having market forces and institutions functioning. Today we can comfortably talk about a considerable improvement of the Turkish economy's ability to respond to external and internal shocks without any public authority's intervention by law and decree. However, this phenomenon itself makes the whole system more vulnerable to any change.

It is important to note that initiating a reform program depends on certain preconditions, but sustaining that program requires some additional ones. Although

the January 1980 program looked comprehensive, in its implementation stage, one key point was ignored or postponed; public-sector finances. That is why inflation remains an unresolved issue. The cost of not addressing this problem directly and in time is that the credibility of the whole program today being questioned.

If we assume that the reforms are completed, then the next concern is to avoid another problem by creating some beneficiaries of the program withing the new system: such as exporters, construction companies, savers, importers, professional market representatives, trade unions, academics, and media professionals, who will lobby for sustaining the reforms. Unfortunately, today what we are observing in Turkey is just the opposite. The current government is facing a real challenge to reverse this situation and initiate a complementary reform package that includes reform of public finances. The vulnerability of the liberalized and deregulated economy should always be a prime concern to public decision makers.

A key deficiency in Turkey's implementation of market oriented reforms was the failure to establish an efficient, speedy and just legal system, whether in the administrative, taxation, or juridical domain. In fact, the most important element of a successful free-market economy is an atmosphere in which there is little or no room for unfair competition. If some market players can easily get away with the reduced rules and regulations without being penalized either by the market or by the law, the new market system easily becomes self-defeating. When that happens, most people blame the market system rather than determinants of that system; the tax and audit system, the state enterprise system, the subsidy system, the court system, and the others.

V. MANAGING ECONOMIC REFORMS AND LONG-RUN GROWTH

A. IMPORTANT FACTORS FOR ECONOMIC DEVELOPMENT

We can define economic development as the process whereby the real per capita income of a country increases over a long period of time subject to the stipulations that the number of people below an "absolute poverty line" does not increase, and that the distribution of income does not become more unequal. We should emphasize process because it implies the operation of certain forces in an interconnected and casual fashion.

Economic development involves something more than economic growth. Development should be explained as "growth plus change": there are some essential qualitative dimensions in the development process that extend beyond the growth of expansion of an economy through a simple widening process. This qualitative difference can be in the improved performance of the factors of production, in the improved techniques of production, in the development of institutions and a change in attitudes and values.

If our focus on the development of a country arises from our desire to remove mass poverty, then we should emphasize as the primary goal a rise in per capita real income rather than simply an increase in the economy's real national income, uncorrected for population change. But, if the criterion were only an increase in real national income, then it would be an improvement in living standards by aggregating output efficiently.

Another important issue is the "long period" of time which is related to a sustained increase in real income. From this standpoint, a five-year development plan is only the start of the development process and it can be seen as the initiating power to sustain the process. But, it should be understood that there is a vital distinction

between initiating development and the more difficult task of sustaining development over the long run.

Although the increase in real income per capita can be adopted as the primary goal, economic development should be interpreted in terms of a number of subgoals and strategic objectives. Thus, the alleviation of poverty and diminution of economic inequality are some of the objectives of development plans. A few of the many possible other subgoals may be the specification of a minimum level of consumption, a certain composition to the consumption stream, and a maximum level of unemployment that will be tolerated; the avoidance of marked disparities in the prosperity and growth of different regions within a country; and the diversification of the economy [Ref. 25:p. 8].

With these variety of policy objectives, the emphasis on various dimensions of economic development can vary at different times and in different countries. That is why it is important to interpret economic development as economic progress or increase in economic welfare.

The process of development has a profound impact on social institutions, habits and beliefs, and it is likely to introduce a number of sources of tension and discord. Tensions arise when the inequalities of income distribution, both among individuals and among regions, tend to increase; when development creates open unemployment and when the pressures of rapid urbanization occur. Discords arise from the contrasts between modern and backward communities -- especially modern functions on traditional institutions.

In this context, a policy maker must adopt his/her approach on first an increase in per capita real income as the best available overall index of economic development, and then the following subgoals and the strategic objectives. The quality of development is completely masked if the policy maker does not pierce the aggregate measure of gross national product (GNP) and consider its composition and

distribution. He/she must recognize several dimensions of economic development. Instead of seeking development as an end, a policy maker might better view it as an instrumental process for overcoming persistent poverty and achieving human development [Ref. 25:p. 9].

B. THE DETERMINANTS OF ECONOMIC GROWTH

For a long time, economists relied on a traditional theory that offered little scope for policy to influence important sources of growth. According to these traditional growth theories, the main determinants of long-run economic growth are not influenced by economic incentives. Recently, however, the study of economic growth has been reinvigorated by new developments in theory and empirical findings that suggest growth is in the sphere of policy [Ref. 26:p. 25]. This new theory, referred to as endogenous growth theory, helps to explain easily movements in long-term economic growth.

Endogenous growth theories are based on the idea that long-run growth is determined by economic incentives. The most popular models of this type maintain that inventions are intentional and generate technological spillovers that lower the cost of future innovations. Naturally, in this model, an educated workforce plays a special role in determining the rate of technological innovation and long-run growth [Ref. 26:p. 28]. The implication is that productivity growth might be related to the structure and policies followed by the economy rather than to nature and luck.

Human capital as an input to production is an important determinant to long-run economic growth. In addition to human capital, a country's economic environment can play an important role in influencing economic growth. For example, internal competitive structure, a country's openness to trade, its political stability, and the efficiency of its government can influence innovative activity and economic growth.

Human knowledge: an educated populace is a key to economic growth. A larger educated workforce may increase growth either because of faster technological progress, as individuals build on the ideas of others, or by simply adding to the productive capacity of a country. One of the important ways for developing countries to advance is through investment in education. [Ref. 26:p. 33]

Political and governmental factors: an extremely unstable government can create insecurity about the future and decrease the incentives to invest in future development. Likewise, people will not invest in developing new products in they can not get the rewards of their ideas. Although, it is difficult to measure property rights in a country, they suffer when the country experiences a large number of revolutions and political assassinations.

If political instability has a negative influence on growth, how does the size of government affect economic growth? The answer is the larger the share of government spending (excluding defense and education) in total Gross Domestic Product (GDP), the lower the growth and investment. The government investment has no statistically significant effect on economic growth. A government may attempt to increase private productivity through government spending, but the evidence suggests it has not such effect and may even decrease growth. Growth appears to fall with higher government spending because of lower private savings and because of the distortionary effects from taxation and government expenditure programs. [Ref. 26:p. 34]

International trade: countries that are open to international trade grow faster than closed economies. A country open to international trade may experience faster technological progress and increased economic growth because the cost of developing new technology falls as more high-tech goods are available. In other words, trade increases growth because it makes a greater variety of products and technologies available.

Equipment investment: equipment investment has potentially large effects on economic growth. New technologies have tended to be embodied in new types of machines. Investments in machinery and equipment are a strategic factor in growth and possibly carry large positive benefits in generating further technological progress.

Overview of determinants behind growth: Table 5.1 summarizes determinants that have been shown to influence growth rates. As the table indicates, determinants that are associated with increasing human or physical capital investment tend to enhance technological progress and economic growth. On the other hand, determinants that reduce incentives to invest, or interfere with well-functioning markets, tend to reduce growth. [Ref. 26:p. 35]

Table 5.1. Determinants of Economic Growth

<u>Growth Enhancing</u>	<u>Growth Reducing</u>
Schooling, education investment	Government consumption spending
Capital savings, investment	Political, social instability
Equipment investment	Trade barriers
Level of human capital	Socialism

Source: [Ref. 26:p. 36]

C. MACROECONOMIC POLICY AND LONG-RUN GROWTH

It is important to address the role of macroeconomic policies in determining long-run rates of productivity growth. This approach can bring some crucial aspects in productivity growth which suggest that much of what is important for raising growth rates lie in the domain of structural policy, since macroeconomic policies are less than dominant in determining rates of productivity growth. In this context, we should focus on two fundamental macroeconomic decisions any society makes:

- how aggregate demand (or its near-equivalent nominal income) will be managed, and
- how total output will be allocated between consumption and various forms of investment.

The policy conclusions can be stated as follows:

- Much of the variation in productivity growth rates can not be traced to macroeconomic policies and must be attributed to structural and external factors. Bad macroeconomic policies can ensure dismal performance, but good macroeconomic policies, while necessary, are not sufficient for outstanding productivity performance [Ref. 27:p. 5].
- Monetary policy that either encourages high inflation or permits large-scale financial collapse can inflict severe damage on productivity growth. Countries in which workers, investors, and entrepreneurs have confidence in the political independence of an inflation-fighting central bank can attain significantly more price stability [Ref. 27:p. 6].
- In developing countries, most of the emphasis is on stabilization rather than growth policies. This emphasis reflects broader social priorities. The media everywhere track unemployment fluctuations much more than productivity fluctuations. Job creation is more prominent in political debates than productivity enhancement.
- Most of the time, governments feel an obligation to use the tools of monetary and fiscal policy to mitigate recessions and avoid depressions without allowing inflation to reach unacceptable levels. However, we can say that the macroeconomic objectives of output stabilization and inflation control are essentially independent of the objective of rapid long-run growth. Long-run growth depends on supply factors such as the accumulation of physical and human capital and technological progress. Inflationary policies can impact levels of output in the short-run, but they can not raise and run the risk of reducing long-run levels of output [Ref. 27:p. 12].
- One of the most fundamental decisions that any society makes is the decision as to how resources are to be allocated between the present and the future, or equivalently between consumption and investment. In terms of policy implications, raising the quality of investment is very important relative to raising the quantity of investment. Finding the highest return investments, and managing public investments as efficiently as possible, is crucial. Identifying and promoting such strategic investments is a critical way in which public policy can promote growth. Much of this involves policy with a structural or microeconomic decision.
- As we discussed earlier, equipment investment has a special role as a trigger of productivity growth. This suggests that neutrality across

assets is an inappropriate goal for tax policies, and that equipment investment should receive special incentives [Ref. 27:p. 6].

D. CONDITIONS FOR ECONOMIC REFORM

Economists can not luxuriate in political agnosticism, telling themselves that they have done their duty once they have offered a menu of policies to politicians. Rather, they must be concerned with the conditions under which their advice is followed and this implies a need to concern themselves with the questions of political economy. In this context, I will try to depict some important conditions that need to be taken into account by economists as well as politicians.

Solid political base: Bringing reforms to fulfil desired results requires acceptable support over time. One would expect that to be difficult unless a government enjoys a solid base of legislative support. A government might be able to compensate for the lack of a strong base of support if the opposition is fragmented and unable to challenge it on reforms that are initially likely to be unpopular.

Social consensus: Reformers should feel constrained by the need to establish a social consensus, or spend their time trying to build one. If reformers succeed, a social consensus will form in support of their measure. This is crucial for sustainability of reform programs. In a democracy, what the public is willing to accept in the way of good economic policy will, at some point, constrain what can be introduced. Economists who want to see good economic policies implemented have a duty to try and educate the public as well as policy makers.

Visionary leadership: Economists should emphasize the importance of leadership. One of the key conditions for successful economic reform is a visionary leader with a sense of history: an individual with a long-term view.

Coherent economic team: Economic reform requires a coherent and united economic team. Reforms will not happen unless an economic team is coherently

organized. In an economy, a good and united team can be a precondition for reform to have a chance.

The presence of a technopol: It is important for successful reform to have economists in positions of political responsibility, rather than serving as technical advisors.

The role of media: It can be a mistake to expect too much from an ability to build support for reform through the use of the media. Media might help at some point to make contact with the public in declaration of gains to winners in order to establish a social consensus.

Most policy oriented economists believe that they have useful advice to give policy makers, and when their advice is disregarded, they tend to say what are intended to be unkind things about failures of leadership and a lack of political will. This fits uncomfortably with the standard professional view that the economist is an expert who informs the policy maker about the range of options, from which the latter selects the one that will maximize the social welfare function that he or she intuitively to be the true expression of society's preferences [Ref. 28:p. 590].

E. STRATEGIC THINKING FOR POLICY MAKING

For the future, Turkey must concentrate on remedial action to overcome the disappointments of the past. Turkey had a number of problems because of inappropriate policies, and their excessive restraint relates to national economic management. The question now is to improve the quality of policy making and to make it much more effective. In order to reach a desired level, policy makers should create better policies. These policies depend on better ideas.

There are some fundamental areas that can be a more intelligent basis for development policy making. One is that of the "unexplained residual factor" [Ref. 29:pp. 91-94]. Many policies bear on supply of inputs, but it is a more difficult

challenge to devise and implement policies to promote the income-raising forces constituting residual.

Another area is the impact of "population growth" on development performance. The consequences of reducing population growth are likely to vary according to policies by which the reduction is achieved [Ref. 30:pp. 276-286].

The last area is the "noneconomic factors" in the development process. Today it is obvious to say that economic, social, and political changes are interrelated. Nonetheless, we can not predict under which conditions and by what mechanisms it is possible to have the types of sociocultural and political change that will be most favorable for development. It differs from country to country. The policy makers' responsibility in Turkey is to identify the functional relationships between economic and noneconomic factors and their quantitative significance. They should find a better way to operate on economic incentives, attitudes, organizational structure, social relations, and any of the many other factors that connect economic and noneconomic change.

Knowledge of political conditions is especially important to achieve improvements in policy making. Reform in economic policy making also depends on political reform. The focus should be the elimination of corruption and more effective administration. Even if economists do have ideas for appropriate policies -- even if they do agree on what has gone wrong and how to put it right -- will government policy makers listen to them? Economists recommend stabilization programs, but inflation remains recurrent and governments practice stop-go measures.

The policy makers' objective may not be efficiency, but that of rising employment, lower prices out of consideration for welfare, and a more equitable distribution of income and wealth. Policy makers may also have to adopt alternative or complementary policies because they can not solve other problems when there are multiple objectives.

The policy maker lives within a constraint policy triangle. At one vertex is accelerated development; at the second, external balance; and at the third, freer trade. The three objectives can not be achieved simultaneously. In favor of accelerated development, the policy maker should adopt complementary policies with respect to trade and balance of payments.

In this context, we should attempt to explain why government failures occur. A careful analysis can be the first step in answering this question. As depicted in Figure 5.1, economists offer predictions and prescriptions to the policy maker, who in turn exercises a policy choice that is implemented with a resultant policy outcome. In offering prescriptions, the economist is guided by some notion of the public interest, generally based on welfare economics. There are other forces, categorized as society-centered or state-centered, which impinge on the policy maker and determine policy choice. The society-centered forces provide societal inputs to a passive government and the policy choice becomes a dependent variable. The demand from society creates the supply of policy. On the other hand, state-centered forces have their own objectives. They are autonomous and active for policy choice [Ref. 31:pp. 580-581]. The problem begins with harmonizing these inputs as a whole to come up with the best policy choice. The policy makers' responsibility is to balance these factors for the sake of the continuity of the policy making process.

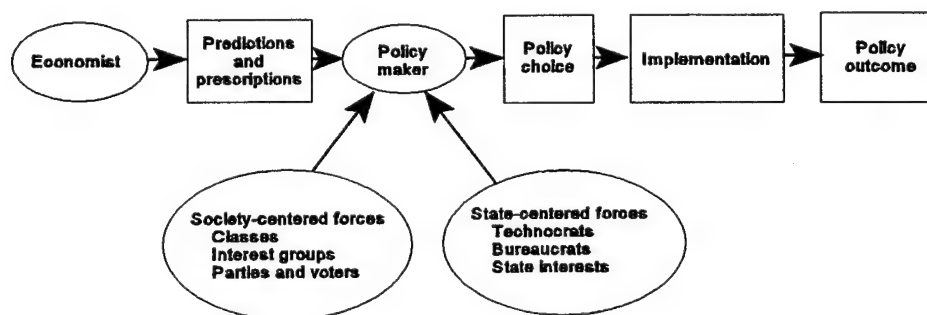


Figure 5.1. The Policy Formation Process

Source: [Ref. 31:p. 581]

To achieve an improvement in the quality of policy making does not mean to focus only on centralized planning or the laissez-faire of a minimalist state. For each of these types of economic management, the disadvantages outweigh the advantages. What is needed instead is the avoidance of both market failure and government failure. While correcting market failure, economic management must restrict government to doing only what the government can do better than the private sector. [Ref. 31:p. 581-582]

Political stability is one of the crucial issues for development. The empirical evidence confirms that political instability hinders development. Most important for stability and continuity of policy reform is an understanding of what causes the successes of government policy.

If economists are to become more influential in advising how to correct nonmarket failures and overcome resistance to policy reform, they will have to give more attention to policy situations. It is especially necessary to make policy changes transparent by identifying the distribution of not only the economic, but also the political, costs and benefits of policy changes, and by identifying the gainers and losers. To promote policy reform, it is then necessary to examine possible ways to compensate the loser, discover the possibilities for building supportive coalitions, and consider the scope for alternative institutional arrangements. It is especially important to insulate policy makers from rent-seekers and interest groups so that government can give more attention to the efficiency of the economy and less to distribution for favor-seeking groups. [Ref. 31:p. 584]

VI. CONCLUSION

The purpose of this research has been to bring together in one document as much of the unclassified information as possible concerning a careful analysis of the Turkish experience in economic stabilization during the 1980s. It has identified the factors that have affected Turkey's economy during this period and provided statistical and analytical data to assess the sustainability of the Turkish program. Interpretation of these data and generalizations drawn as to the efficiency of economic policy making led to the following conclusion.

The Turkish economy is facing the risk of relative stagnation as we approach the next century. Without any significant improvement in the efficiency of investments, the role of capital formation is significantly lower than that of sixteen years ago, leading to a lower rate of potential growth. Both investment and saving rates are lower than the requirements of a dynamic growth.

Turkey's experience during the 1980s in implementing market-oriented reforms as part of a growth-oriented adjustment strategy suggests that a set of comprehensive and coherent reform policies backed by political determination and public support can make economic recovery leading to a sustainable growth possible.

Every country embarking on structural transformation will necessarily have different sets of policies and instruments to choose from. But whatever policies and instruments a country selects, the commitment and the determination of the political authority to carry the program through, and the confidence of the public in its economic leadership are essential ingredients for success. No country undertaking a major structural transformation through market orientation should adopt a static or fixed strategy. Given the dynamic nature of developing country economies on the one hand, and the unstable but mostly progressive nature of international markets on the other, the initial set of reform policies will be and should be subject to continuous

review. In fact, one of the most significant results of any market-oriented structural program is to increase and improve the economy's ability to respond to internal and external developments through market forces. Economic growth is an imperative, not a choice. Without growth, a country can not achieve anything else. But what is important today is a model of growth that links that growth with the lives of people. The problem now is how to survive, not how to grow sufficiently rapidly, for the new concept of sustainable development is based on structural economic, human, and environmental constraints.

Today, no one challenges the achievements of market orientation in Turkey. With the momentum acquired during the 1980s, people are looking for new dimensions, challenges, new visions and new directions. Particularly the end of the Cold War created the question of Turkey's reemerging identity with force. At this juncture, on the way to integration with the international economic system, Turkey's challenge is to pursue, uninterruptedly, its adjustment and transformation into a market economy, and its democratization, to secure sustainable but rapid growth and provide the living standards that Turkish people have come to expect. Dynamism should be kept going. This dynamism looks solid and deep rooted, but it can be lost if it is mismanaged.

The Turkish people know the importance of transformation. They don't want to be marginalized within the context of EC. The Turkish people must consolidate the evolving world economy and reforms, and have to accelerate the public sector activities, including privatization in order to take full advantage of global opportunities. Everyone knows these opportunities should not be missed for future benefits and expectations.

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